



Financials

2000

Management's Discussion and Analysis of Financial Condition and Results of Operations

(Dollars in Thousands, Except Per Share Data)

Some of the statements made by us in this annual report discuss future expectations, contain projections of results of operations or financial condition or state other forward-looking information. Those statements are subject to known and unknown risks, uncertainties and other factors that could cause the actual results to differ materially from those contemplated by the statements. The "forward-looking" information is based on various factors and was derived using numerous assumptions. In some cases, these so-called forward-looking statements can be identified by words like "may," "will," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "potential," or "continue" or the negative of those words and other comparable words. These statements only reflect our predictions. Actual events or results may differ substantially. Important factors that could cause actual results to be materially different from anticipated results and expectations expressed in any forward-looking statements made by or on behalf of us include availability of financing, ability to obtain regulatory approvals, uncertainty relating to economic conditions, government and regulatory policies, pricing and availability of equipment, materials, inventory and programming, the number of potential customers in a target market, the completion of acquisitions or divestitures, acceptance of our services, the availability and success of strategic alliances or relationships, technological, regulatory or other developments in the industry, changes in the competitive climate in which we operate, and the emergence of future opportunities. These and other applicable risks are summarized under the caption "Risk Factors" in the Company's Registration Statement on Form S-3 filed with the Securities and Exchange Commission on June 2, 2000. Statements in this annual report should be evaluated in light of these important factors.

The following discussion should be read in conjunction with the Company's historical Consolidated Financial Statements and Notes thereto:

■ General

The Company's primary business is delivering bundled communications services to residential customers over the Company's own network to 7 of the 10 most densely populated areas of the country. The Company currently operates in Boston, New York, Philadelphia suburbs, Washington, D.C., Chicago, San Francisco and Los Angeles.

ResiLinkSM is the brand name of the Company's bundled service that enables residential customers to enjoy a bundle of Phone, Cable TV and High-Speed Internet for a flat monthly price. The bundles are designed to appeal to consumers seeking simplification and value. In addition to ResiLinkSM, the Company sells Phone, Cable TV and dial-up Internet to residential customers on an a-la-carte basis, and the Company provides communications services to commercial customers. The Company is working to leverage the excess capacity of its MegabandTM Network to allow the Company to expand its offering of new services.

The Company's services are delivered over its own high-speed, high capacity, fiber-optic MegabandTM Network. The Company is building its MegabandTM Network in the most densely populated areas of the nation, which gives the Company access to 44% of the residential telecommunications market by building its network in only 6% of the nation's geography. The Company generally builds its MegabandTM Network in communities where it can reach up to 150 homes per mile of network plant. By comparison, the average

density level of the cable incumbents and the phone incumbents is 38 and 26 homes per mile of plant, respectively (Source: The Yankee Group). The Megaband™ Network is a unique broadband fiber-optic platform that employs SONET ring backbone architecture and localized nodes. This architecture allows the Company to bring its state-of-the-art fiber-optics to travel within approximately 900 feet of its customers, with fewer electronics and lower maintenance costs than existing competitors' local networks. The Company has designed the Megaband™ Network to have significant excess capacity. The Company believes that it has the capability of adding new communications services much more efficiently and effectively than the incumbents or other competitors could manage.

There can be no assurance that the Company will achieve or sustain profitability or positive operating income in the future as it develops its networks.

The operating losses have resulted primarily from expenditures associated with the development of the Company's operational infrastructure, expanding the level of service provided to our customers and sales and marketing expenses. The Company expects it will continue to experience negative operating income while it continues to invest in its network and until such time as revenue growth is sufficient to fund operating expenses. The Company expects to achieve positive operating margins over time by (i) increasing the number of customers it serves, (ii) increasing the number of connections per customer by cross marketing its services and promoting bundled service options and therefore increasing the revenue per customer, (iii) lowering the costs associated with new subscriber additions and (iv) reducing the cost of providing services by capturing economies of scale. The Company expects its operating revenues will increase in future periods through internal growth of its current fiber-optic network, increases in customers, and increases in the number of services per customer. When the Company makes an investment in a new market, the operating losses typically increase as the network and sales force are expanded to facilitate growth. The Company's ability to generate positive cash flow in the future will depend on the extent of capital expenditures, the ability to generate revenues, competition in the market and any potential adverse regulatory developments. The Company will be dependent on various financing sources to fund its growth as well as continued losses from operations. There can be no assurance that such funding will be available, or available on terms acceptable to the Company. See—"Liquidity and Capital Resources."

The terms of the Company's joint venture operating agreements require the mutual consent of the Company and its joint venture partner to distribute or advance funds to the Company. The Company's debt agreements allow subsidiaries and joint ventures to incur indebtedness for network buildout costs, which indebtedness may contain limitations on the subsidiaries' and the joint ventures' ability to pay dividends and distributions to the Company. Cash flows available to the Company in future periods will be affected by the extent to which operations are conducted through joint ventures. Due to the degree of control that the Company has in the joint ventures, the Company accounts for the NStar Communications, Inc. joint venture on a consolidated basis and Starpower and Megacable under the equity method of accounting.

Management believes that the Company operates as one reportable operating segment, which contains many shared expenses generated by the Company's various revenue streams and that any segment allocation of shared expenses incurred on a single network to multiple revenue streams would be impractical and arbitrary; furthermore, the Company currently does not make such allocations internally. The Company's chief decision-makers do, however, monitor financial performance in a way which is different from that depicted in the historical general purpose financial statements in that such measurement includes the consolidation of all joint ventures, including Starpower, which is not consolidated under generally accepted accounting principles. Such information, however, does not represent a separate segment under generally accepted accounting principles and therefore it is not separately disclosed.

■ Results of Operations

Year Ended December 31, 2000 Compared to Year Ended December 31, 1999:

For the year ended December 31, 2000, sales increased \$57,457, or 20.8%, to \$333,450 from \$275,993 for the same period in 1999. Operating losses before non-cash stock-based compensation, depreciation and amortization was (\$331,959) as compared to (\$131,967) for the same period in 1999.

Net loss was (\$891,466), or (\$10.59) per average common share for 2000 and (\$368,570) or (\$5.12) per average common share for 1999.

■ Sales

Phone sales include local telephone service fees consisting primarily of monthly line charges, local toll and special features and long-distance telephone service fees based on minutes of traffic and tariffed rates or contracted fees. Phone sales include both resold services and traffic over the Company's own switches.

Cable TV sales are comprised primarily of subscription fees for basic, premium and pay-per-view cable television services; all of the Company's networks can support these services. A digital tier of cable service is being deployed in selected markets.

Internet sales represent Internet access fees through high-speed cable modems and 56K dial-up modems as well as related revenues from web hosting and dedicated access.

Total sales increased \$57,457, or 20.8%, to \$333,450 for the year ended December 31, 2000 from \$275,993 for the year ended December 31, 1999. The increase was fueled by higher average service connections, which increased 11.3% to 1,011,709 for the year ended December 31, 2000 (including connections of the Starpower joint venture) from 909,343 for the year ended December 31, 1999. The increase in average service connections resulted principally from growth in average on-net connections,

which increased 99.4% from 169,956 for the year ended December 31, 1999 to 338,825 for the year ended December 31, 2000. Total on-net connections increased 112.4% from 222,964 at December 31, 1999 to 473,556 at December 31, 2000. Advanced fiber units passed increased 104.0% to 1,455,907 units at December 31, 2000 from 713,823 units at December 31, 1999.

Phone sales increased \$12,946, or 23.8%, to \$67,372 for the year ended December 31, 2000 from \$54,426 for the year ended December 31, 1999. Approximately \$13,679 of the increase in phone sales is attributable to higher average connections. Average on-net phone connections increased approximately 97.7% to approximately 93,905 for the year ended December 31, 2000 (including connections of the Starpower joint venture) from approximately 47,491 for the year ended December 31, 1999. Average off-net phone connections were approximately 44,712 and 55,710 at December 31, 2000 and 1999, respectively. The increase in phone sales due to higher average connections was partially offset by lower average revenue per connection of 1.8%. Minutes, calls and average length increased while revenue per minute decreased.

Cable TV sales increased \$28,226, or 22.5%, to \$153,511 for the year ended December 31, 2000 from \$125,285 for the year ended December 31, 1999. The increase was primarily due to approximately 68,596 additional average cable TV connections for the year ended December 31, 2000 as compared to the year ended December 31, 1999. Average on-net cable TV connections grew 95,234, or 87.5%, to 204,051 for the year ended December 31, 2000 (including connections of the Starpower joint venture) from 108,817 for the year ended December 31, 1999. Average off-net cable TV connections were approximately 141,374 and 168,012 for the year ended December 31, 2000 and 1999, respectively. Overall higher service connections contributed approximately \$22,196 to the increase in cable TV sales and higher average revenue per connection of 0.7% principally contributed the remainder.

Internet sales increased \$8,768, or 12.9%, to \$76,518 for the year ended December 31, 2000 from \$67,750 for the year ended December 31, 1999. The increase was primarily due to approximately 27,221 additional average on-net Internet connections for the year ended December 31, 2000 as compared to the year ended December 31, 1999. Although total average Internet connections decreased, monthly average revenue per connection increased by 13.3% due to a higher mix of high-speed Internet services in 2000.

For the year ended December 31, 2000, the Company had approximately 486,798 average off-net Internet connections and approximately 40,869 average on-net Internet connections, including connections of the Starpower joint venture. For the year ended December 31, 1999, the Company had approximately 515,665 average off-net Internet connections and approximately 13,648 on-net Internet connections, including connections of the Starpower joint venture.

Other sales increased \$7,518, or 26.3%, to \$36,050 for the year ended December 31, 2000 from \$28,532 for the year ended December 31, 1999. The increase was due primarily to higher reciprocal compensation. Reciprocal compensation is the fee local exchange carriers pay to terminate calls on each other's networks. Because of the uncertainty of various regulatory rulings which affect the collectibility of this revenue, the Company recognizes this revenue as it is realized.

■ Costs and Expenses, Excluding Stock-Based Compensation, Depreciation and Amortization

Costs and expenses, excluding stock-based compensation, depreciation and amortization are comprised of direct costs, operating, selling and general and administrative expenses.

Direct expenses include direct costs of providing services, primarily Cable TV programming, franchise costs and network access fees.

Direct expenses increased \$36,225, or 25.8%, to \$176,673 for the year ended December 31, 2000 from \$140,448 for the year ended December 31, 1999. The increase was principally the result of higher sales, a lower margin on cable TV sales due to higher franchise fees and programming rates, and a lower margin on Internet sales due to increased costs associated with expansion of our backbone, building redundancy in our backbone and certain technology upgrades.

Operating, selling and general and administrative expenses primarily include customer service costs, advertising, sales, marketing, order processing, telecommunications network maintenance and repair ("technical expenses"), general and administrative expenses, installation and provisioning expenses, and other corporate overhead.

Operating, selling and general and administrative costs increased \$221,225, or 82.7%, to \$488,737 for the year ended December 31, 2000 from \$267,512 for the year ended December 31, 1999.

Customer services costs, including order processing, increased approximately \$46,517, or 116.9%, for the year ended December 31, 2000 as compared to the year ended December 31, 1999. The increase is primarily internal and external personnel related to support the increase in average connections over the comparable period in 1999 and to increase the level of service. The increases were primarily for customer service representatives and provisioners which facilitated a "warm call" program which contacts customers within 48 hours after initiating services and a corresponding decline in the number of calls per connection. Additionally, personnel additions were made to support the Company's target of a lower ratio of connections to customer service representatives. The increase is primarily personnel related to support the 11.3% increase in average connections over the comparable period in 1999 and to increase the level of service provided to our customers. The remainder of the increase was attributable to rental and utility expenses of approximately \$7,896, primarily telephone.

Technical expense, including installation and provisioning, increased approximately \$49,564, or 91.1%, for the year ended December 31, 2000 as compared to the year ended December 31, 1999. Technical expense increases of approximately \$32,039 were due to engineering and construction headcount and contract labor additions made to plan and execute network expansion and network operations control center monitoring, net of approximately \$62,500 increase in costs capitalized as part of the cost basis of the telecommunications network. Rental and utility expense, primarily for material storage and hub sites, increased approximately \$5,851. The remainder of the increase was principally due to repair and maintenance costs relating to the network and the fleet of approximately \$7,626.

Sales and marketing costs increased approximately \$41,721, or 112.4%, for the year ended December 31, 2000 as compared to the year ended December 31, 1999. An increase of approximately \$35,672 resulted principally from additional staff and related commissions and benefits, to cover increases in marketable homes, to increase penetration in the Company's existing markets and to increase the number of services per customer. The remaining increase relates to additional sales and promotion expenses of approximately \$4,764.

General and administrative expenses increased approximately \$83,301, or 82.2%, for the year ended December 31, 2000 as compared to the year ended December 31, 1999. Employee expenses increased approximately \$19,586 as a result of increased support staff to support expanded operations. Information technology expenses increased approximately \$2,923. The Company is in the process of developing information technology systems which will provide a sophisticated customer care infrastructure as well as other administrative support systems. The expense increases represent primarily staff additions to both support this effort and maintain the systems as well as maintenance contracts costs partially offset by a reduction in consulting expenses.

Operating taxes, primarily property taxes, increased approximately \$6,457 as a result of expanded operations. External professional fees, primarily legal expense, increased approximately \$4,463 primarily associated with the procurement of regulatory approvals for potential future markets. Rent, utility and maintenance expense increased approximately \$17,877 primarily related to additional space required to support the increase in headcount. Higher bad debt expense of approximately \$3,218 was associated with the increase in sales. The remaining increase primarily represents additional development and support expenses associated with expanding operations and new markets.

■ Stock-Based Compensation

As of January 1, 2000 the Company has adopted the recognition provisions of SFAS No. 123—"Accounting for Stock-Based Compensation" ("SFAS 123"). Under SFAS 123, the fair value of an option on the date of the grant is amortized over the vesting periods of the options in accordance with Financial Accounting Standards Board ("FASB") Interpretation No. 28—"Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans" ("FIN 28"). The recognition provisions of SFAS 123 are applied prospectively upon adoption. As a result, the recognition provisions are applied to all stock awards granted in the year of adoption and are not applied to awards granted in previous years unless those awards are significantly modified. The adoption of SFAS 123 resulted in non-cash charges to operations of \$41,237 in 2000. The Company applied Accounting Principles Board Opinion No. 25—"Accounting for Stock Issued to Employees" ("APB 25") in accounting for its stock options, prior to January 1, 2000. (See Note12)

■ Depreciation and Amortization

Depreciation and amortization was \$285,648 for the year ended December 31, 2000 and \$146,043 for the year ended December 31, 1999. The increase of \$139,605 was the result of a higher depreciable

basis of plant resulting primarily from expansion of the Company's advanced fiber-optic network, and amortization of intangible assets arising primarily from the acquisition of 21st Century in April of 2000. The cost basis of property, plant and equipment in service at December 31, 2000 and 1999 was \$1,751,845 and \$812,667, respectively. The basis of intangible assets was \$664,596 and \$296,875 at December 31, 2000 and 1999, respectively.

In future periods, depreciation and amortization are expected to exceed amounts recorded in 2000 due to depreciation with respect to expansion of the Company's advanced fiber-optic network.

■ Interest Income

Interest income was \$140,159 and \$76,786 for the year ended December 31, 2000 and 1999, respectively. The increase of \$63,373, or 82.5%, results from higher average cash, temporary cash investments and short-term investments as compared to the same period in 1999 primarily due to the Vulcan investment in 2000. Cash, temporary cash investments and short-term investments were approximately \$1,723,000 at December 31, 2000 and approximately \$1,793,000 at December 31, 1999. During 2000, a full year's worth of interest income from the proceeds of the following significant financing transactions increased cash, temporary cash investments and short-term investments year over year: (1) the issuance of 1,650,000 shares of a new issue of the Company's Series B Preferred Stock in February 2000, which yielded net proceeds of approximately \$1.6 billion, (2) the issuance of 250,000 shares of a new issue of the Company's Series A Preferred Stock in April 1999, which yielded net proceeds of approximately \$240,000, (3) the issuance of 9,200,000 shares of the Company's Common Stock, in May 1999, which yielded net proceeds of approximately \$344,000 and (4) \$875,000 from new borrowings, partially offset by the repayment of the Company's \$100,000 term loan (Note 10). These increases were partially offset by capital expenditures of approximately \$1,127,869 and working capital requirements.

■ Interest Expense

For the year ended December 31, 2000, interest expense was \$223,868 as compared to \$158,139 for the year ended December 31, 1999. The increase resulted primarily from higher interest and commitment fees of \$62,550 relating to the Company's Credit Facility, of which \$500,000 was drawn down in June 1999. The remaining increase is due to higher accretion on the 11.125%, 9.8% and 11% senior discount notes issued in October 1997, February 1998 and June 1998, respectively, of \$11,096 and to higher amortization of debt issuance costs of approximately \$2,700. These increases were partially offset primarily by higher capitalized interest aggregating approximately \$8,330.

■ Write-Down of Equity Investment

Results for 2000 included a write-down of \$24,418 on an equity investment, which represents the Company's full investment in JuniorNet Corporation ("JuniorNet"). The Company currently owns a 47.5% interest in JuniorNet. Although JuniorNet is still seeking a buyer or a strategic merger partner for the business, estimated future cash flows related to this investment indicated that an impairment of the full value had occurred.

■ Income Tax

The Company's effective income tax rate was a benefit of 0.6% and 1.4% for the year ended December 31, 2000 and December 31, 1999, respectively. The tax effect of the Company's cumulative losses has exceeded the tax effect of accelerated deductions, primarily depreciation, which the Company has taken for federal income tax purposes. As a result, generally accepted accounting principles do not permit the recognition of such excess losses in the financial statements. This accounting treatment does not impact cash flows for taxes or the amounts or expiration periods of actual net operating loss carryovers. For additional analysis of the changes in income taxes, see the reconciliation of the effective income tax rate in Note 11 to the consolidated financial statements.

■ Minority Interest

For the year ended December 31, 2000 and 1999, minority interest of \$24,515 and \$28,262, respectively, primarily represents the interest of NSTAR Communications, Inc. in the loss of RCN-BECOCOM.

■ Equity in the Loss of Unconsolidated Entities

For the year ended December 31, 2000, equity in the loss of unconsolidated entities primarily represents the Company's share of the (income)/losses and amortization of excess cost over net assets of Megacable of (\$1,695), Starpower of \$20,208 and JuniorNet of \$15,984. For the year ended December 31, 1999, equity in the loss of unconsolidated entities primarily represents the Company's share of the losses and amortization of excess cost over net assets of Megacable of \$1,763, Starpower of \$12,200 and JuniorNet of \$19,997.

Year Ended December 31, 1999 Compared to Year Ended December 31, 1998:

For the year ended December 31, 1999, sales increased \$65,053, or 30.8% to \$275,993 from \$210,940 for the same period in 1998.

Operating losses before non-recurring charges, acquired research and development, depreciation, and amortization, was (\$131,967) as compared to (\$51,412) for the same period in 1998.

Net loss was (\$368,570), or (\$5.12) per average common share for 1999 and (\$205,442) or (\$3.36) per average common share for 1998.

■ Sales

For the year ended December 31, 1999, total sales were \$275,993, an increase of \$65,053 or 30.8%, from \$210,940 for the year ended December 31, 1998. The increase resulted from higher average service connections, which increased 32.4% to approximately 909,000 at December 31, 1999 from approximately 687,000 at December 31, 1998. The increase in average service connections resulted

principally from the growth in dial-up Internet connections and growth in average on-net connections, which increased 245.5% from approximately 49,000 for the year ended December 31, 1998 to approximately 170,000 for the year ended December 31, 1999. Total on-net connections increased 80.7% from 123,393 at December 31, 1998 to 222,964 at December 31, 1999. Advanced fiber units passed increased 134.4% to 713,823 units at December 31, 1999 from 304,505 units at December 31, 1998.

Phone sales increased \$19,506, or 55.9%, to \$54,426 for the year ended December 31, 1999 from \$34,920 for the year ended December 31, 1998. Approximately \$22,000 of the increase in phone sales is attributable to higher average connections. Average advanced fiber phone connections increased approximately 292.1% to approximately 47,500 for the year ended December 31, 1999 (including connections of the Starpower joint venture) from approximately 12,000 for the year ended December 31, 1998. Average off-net phone connections increased approximately 12.2% to approximately 55,700, for the year ended December 31, 1999 from approximately 49,700 for the year ended December 31, 1998. The increase in phone sales due to higher average connections was partially offset by lower average revenue per connection of 2.0%. Although minutes, calls and average length increased, revenue per minute declined.

During the fourth quarter of 1999, the Company ceased marketing new customers for resale of its competitors' local phone service. The Company expects that the effect of this decision will be lower revenue growth than would result if such resale continued; however, this decision is also expected to have a positive impact on the Company's overall gross margin percentage and a neutral effect on operating income before depreciation and amortization ("EBITDA").

Cable TV sales increased \$12,207, or 10.8%, to \$125,285 for the year ended December 31, 1999 from \$113,078 for the year ended December 31, 1998. The increase was primarily due to approximately 27,400 additional average cable TV connections for the year ended December 31, 1999 as compared to the year ended December 31, 1998. Average on-net cable TV connections grew 73,600, or 209.1%, to approximately 108,800 for the year ended December 31, 1999 (including connections of the Starpower joint venture) from approximately 35,200 for the year ended December 31, 1998. Average off-net cable TV connections were approximately 168,000 and 214,200 for the years ended December 31, 1999 and 1998, respectively. Overall higher average service connections contributed approximately \$8,673 to the increase in cable TV sales, and higher average revenue per connection of 1.0% principally contributed the remainder.

Internet sales increased \$27,426, or 68%, to \$67,750 for the year ended December 31, 1999 from \$40,324 for the year ended December 31, 1998. The increase was primarily due to approximately 154,000 additional average Internet connections for the year ended December 31, 1999 as compared to the year ended December 31, 1998.

For the year ended December 31, 1999, the Company had approximately 515,700 average off-net Internet connections and approximately 13,600 average advanced fiber Internet connections, including connections of the Starpower joint venture. For the year ended December 31, 1998, the Company had

approximately 373,400 average off-net Internet connections and approximately 1,900 average advanced fiber Internet connections, including connections of the Starpower joint venture. Overall higher average service connections contributed approximately \$16,500 to the increase in Internet sales, and higher average revenue per connection of 19.2% contributed the remainder.

Other sales increased \$5,913, or 26.1%, to \$28,532 for the year ended December 31, 1999 from \$22,619 for the year ended December 31, 1998. The increase was due primarily to higher reciprocal compensation.

The Company recognizes that managing customer turnover is an important factor in maximizing revenues and cash flow. For the quarter ended December 31, 1999, cable TV average monthly churn rate was approximately 2.3%.

■ Costs and Expenses, Excluding Depreciation and Amortization

Direct expenses increased \$38,139, or 37.3%, to \$140,448 for the year ended December 31, 1999 from \$102,309 for the year ended December 31, 1998. The increase was principally the result of higher sales, a lower margin on Cable TV sales due to higher franchise fees and programming rates, and a lower margin on Internet sales due to transitional costs associated with the conversion of existing circuits to certain technology upgrades.

Operating, selling, general and administrative costs increased \$107,469, or 67.2%, to \$267,512 for the year ended December 31, 1999 from \$160,043 for the year ended December 31, 1998.

Customer services costs, including order processing, increased approximately \$9,700, or 32.3%, for the year ended December 31, 1999 as compared to the year ended December 31, 1998. The increase is primarily personnel related to support the 32.4% increase in average connections over the comparable period in 1998 and to increase the level of service. Customer service costs per average connection per month increased 0.8% in 1999 over 1998.

Technical expense, including installation and provisioning, increased approximately \$23,817, or 77.8%, for the year ended December 31, 1999 as compared to the year ended December 31, 1998. Technical expense increases of approximately \$29,600 were due to engineering and construction headcount and contract labor additions made to plan and execute network expansion and network operations control center monitoring. Rental and utility expense, primarily for material storage and hub sites, increased approximately \$5,500, partially offset by an increase of approximately \$12,100 in technical costs capitalized as part of the cost basis of the telecommunications network.

Sales and marketing costs increased approximately \$8,000, or 27.6%, for the year ended December 31, 1999 as compared to the year ended December 31, 1998. The increase resulted principally from additional staff and related commissions and benefits, to cover increases in marketable homes, to increase penetration in the Company's existing markets and to increase the number of services per customer.

Advertising costs increased approximately \$10,900, or 45.5%, for the year ended December 31, 1999 as compared to the year ended December 31, 1998. The increase is primarily related to costs incurred to begin to develop brand awareness in the California market as well as continued expansion of existing markets.

General and administrative expenses increased approximately \$55,000, or 118.8%, for the year ended December 31, 1999 as compared to the year ended December 31, 1998. Information technology expenses increased approximately \$15,700. The Company is in the process of developing information technology systems which will provide a sophisticated customer care infrastructure as well as other administrative support systems. The expense increases represent staff additions to both support this effort and maintain the systems as well as consulting expenses associated with the planning and analysis stages of such systems development. The Company expects that such charges may increase in future periods until the planning and analysis stages of its information technology systems development projects are complete.

Operating taxes, primarily property taxes, increased approximately \$2,800 as a result of expanded operations. External legal expense increased approximately \$4,000 primarily associated with the procurement of regulatory approvals for potential future markets. Approximately \$19,500 of the increase in general and administrative expense is attributable to acquisitions in 1998, which were included for a full twelve months in 1999, the June 1998 acquisition of Lancit Media, which was disposed of in April 1999, and the 1999 acquisitions of DNAI and Brainstorm. Rent and utility expense increased approximately \$4,800 primarily related to additional space required to support the increase in headcount. Higher bad debt expense of approximately \$3,700 was associated with the increase in sales. The remaining increase primarily represents additional development and support expenses associated with expanding operations and new markets.

■ Depreciation and Amortization

Depreciation and amortization was \$146,043 for the year ended December 31, 1999 and \$89,088 for the year ended December 31, 1998. The increase of \$56,955, or 63.9%, was the result of a higher depreciable basis of plant resulting primarily from expansion of the Company's advanced fiber network, and amortization of intangible assets arising from the acquisitions in 1999. The cost basis of property, plant and equipment at December 31, 1999 and 1998 was \$1,123,760 and \$601,679, respectively. The basis of intangible assets was \$296,875 and \$267,031 at December 31, 1999 and 1998, respectively.

■ Acquired In-Process Research and Development

In connection with the acquisitions of Erols and UltraNet, RCN has allocated \$13,228 for Erols and \$5,065 for UltraNet to in-process research and development ("IPR&D"). Specifically, four projects were identified which qualified as IPR&D by definition of not having achieved technological feasibility and representing technology which at the point of acquisition offered no alternative use than the defined project. The fair value of the IPR&D projects associated with these acquisitions is based upon a discounted cash flow analysis modified to represent only that portion of the project associated with completed research

and development efforts at the date of acquisition. The IPR&D valuation charge was measured by the stage of completion method. The expected completion percentages are estimated based on the available financial information at the date of acquisition and were established on a project by project basis primarily calculated by dividing the costs incurred to date by the total expected R&D expenses specific to the project. The significant assumptions utilized by management were as follows:

Cash flow projections, utilizing risk adjusted discount rates of between 35% and 40% for Erols projects, commenced in 1998, and were expected to grow significantly in 1999 and 2000. Cash flow projections, utilizing risk adjusted discount rates of between 30% and 33% for UltraNet projects, were expected to commence in 1999, growing significantly in 2000 and 2001. The IPR&D projections are founded on significant assumptions with regard to timing of market entrance, levels of penetration, and costs of provisioning.

The Company is constructing new telecommunications networks. The margins on products expected to result from acquired in-process technologies, in some cases, represent higher margins than the Company's margins on existing products primarily due to the efficiencies in delivering multiple products, including bundled-service offerings, over a single state-of-the-art, high capacity fiber-optic network.

■ Interest Income

Interest income was \$76,786 and \$58,679 for the year ended December 31, 1999 and 1998, respectively. The increase of \$18,107, or 30.9%, results from higher average cash, temporary cash investments and short-term investments as compared to the same period in 1998. Cash, temporary cash investments and short-term investments were approximately \$1,793,000 at December 31, 1999 and approximately \$1,013,000 at December 31, 1998. During 1999, proceeds from the following significant financing transactions increased cash, temporary cash investments and short-term investments: (1) the issuance of 250,000 shares of a new issue of the Company's Series A Preferred Stock in April 1999, which yielded net proceeds of approximately \$240,000, (2) the issuance of 9,200,000 shares of the Company's Common Stock, in May 1999, which yielded net proceeds of approximately \$344,000 and (3) \$875,000 from new borrowings, partially offset by the repayment of the Company's \$100,000 term loan (Note 10). These increases were partially offset by capital expenditures of approximately \$526,000 and working capital requirements.

■ Interest Expense

For the year ended December 31, 1999, interest expense was \$158,139 as compared to \$112,239 for the year ended December 31, 1998. The increase resulted primarily from higher interest and commitment fees of \$30,275 relating to the Company's Credit Facility, which the Company entered into with Chase Manhattan Bank in June 1999 (Note 10), of which \$500,000 of the Term Loan B was borrowed in June 1999. The remaining increase is due to higher accretion on the 11.125%, 9.8% and 11% senior discount notes issued in October 1997, February 1998 and June 1998, respectively, of \$20,976 and to higher amortization of debt issuance costs of approximately \$2,700. These increases were partially offset primarily by lower interest of approximately \$4,300 relating to the prepayment of the \$100,000 term loan (Note 10) and higher capitalized interest aggregating approximately \$5,100.

■ Gain on the Sale of Lancit

In April 1999, the Company sold its investment in Lancit to JuniorNet, a commercial-free online learning service for children, for approximately \$24,600 in cash. Concurrent with the sale, the Company acquired an ownership interest in JuniorNet of approximately 47.54%. The Company recognized a \$8,930 gain on the sale. The Company also deferred \$8,201 representing the portion of the gain attributable to the Company's ownership interest in JuniorNet immediately after the acquisition.

■ Income Tax

The Company's effective income tax rate was a benefit of 1.4% and 2.3% for the year ended December 31, 1999 and December 31, 1998, respectively. The primary reason for the difference is that the tax effect of the Company's cumulative losses has exceeded the tax effect of accelerated deductions, primarily depreciation, which the Company has taken for federal income tax purposes. As a result, generally accepted accounting principles do not permit the recognition of such excess losses in the financial statements. This accounting treatment does not impact cash flows for taxes or the amounts or expiration periods of actual net operating loss carryovers. For additional analysis of the changes in income taxes, see the reconciliation of the effective income tax rate in Note 11 to the consolidated financial statements.

■ Minority Interest

For the year ended December 31, 1999 and 1998, minority interest of \$28,262 and \$17,162, respectively, primarily represents the interest of NSTAR Securities in the loss of RCN-BECOCOM.

■ Equity in the Loss of Unconsolidated Entities

For the year ended December 31, 1999, equity in the loss of unconsolidated entities primarily represents the Company's share of the losses and amortization of excess cost over net assets of Megacable of \$1,763, Starpower of \$12,200 and JuniorNet of \$19,997. For the year ended December 31, 1998, equity in the loss of unconsolidated entities primarily represents the Company's share of the losses and amortization of excess cost over net assets of Megacable of \$2,384 and Starpower of \$10,335.

■ Extraordinary Item—Prepayment of Debt

In June 1999, the Company prepaid a term loan with the proceeds of the Credit Facility (Note 10). The early extinguishment of the debt resulted in the write-off of the applicable unamortized debt issuance cost, which is reflected as an extraordinary charge of (\$424).

■ Liquidity and Capital Resources

Because our network development plan involves relatively low fixed costs, we are able to schedule capital expenditures to meet expected subscriber growth in each major market. Our principal fixed costs in each such market are incurred in connection with the establishment of a cable TV transmission and telephone switching facility. To make each market economically viable, it is then necessary to construct infrastructure to connect a minimum number of subscribers to the transmission and switching facility. We phase our market entry projects to ensure that we have sufficient cash on hand to fund this construction.

The Company's business plan will require a substantial amount of capital expenditures, a substantial portion of which will be incurred before any significant related revenues are expected to be realized. These expenditures, together with associated early operating expenses, may result in substantial negative operating cash flow and substantial net operating losses for the Company for the foreseeable future. The Company's spending will be primarily to fund the construction of its network, fund operating losses and repay its debts. The Company believes its currently available funds are sufficient to fund development of the markets the Company has committed to entering. The implementation of the Company's business plan in new markets will require substantial additional capital.

The Company may not be successful in producing sufficient cash flow, raising sufficient debt or equity capital on terms that it will consider acceptable, or selling phone, cable TV and Internet services. Further, expenses may exceed the Company's estimates and the financing needs may be higher than estimated. Failure to generate sufficient funds may require the Company to delay or abandon some of its future expansion or expenditures, which could have a material adverse effect on the implementation of the Company's business plan. The Company may not be able to obtain such financing if and when it is needed or that, if available, will be on terms acceptable to the Company.

As of the end of the year, the Company had \$2.2 billion in cash and available funds.

The Company expects to supplement its existing available credit facilities, available cash and operating cash flow by continuing to seek to raise capital to increase its network coverage and pay for other capital expenditures, working capital, debt service requirements, anticipated future operating losses and acquisitions.

The Company's current joint ventures reduce the amount of expenditures required by the Company to develop the network due to the anticipated joint venture partners' equity contributions. However, the joint venture arrangements will also reduce the potential cash flows to be realized from operation of the network in the markets in which the joint ventures operate and restrict the Company's access to cash flow generated by the joint ventures (which would be paid in the form of dividends). The Company may enter into additional joint ventures in the future.

On February 28, 2000, the Company and Vulcan Ventures Incorporated ("Vulcan"), the investment organization of Paul G. Allen, completed a transaction which culminated in Vulcan acquiring a \$1.65 billion investment in the Company in the form of mandatorily convertible preferred stock (the "Preferred Stock"), which will be converted into the Company's Common Stock, ("Common Stock"), no later than seven years after it is issued, if not previously called or converted. Vulcan purchased 1,650,000 shares of the Preferred Stock. The Preferred Stock has a liquidation preference of \$1,000 per share and is convertible into Common Stock at a price of \$62 per share. The Preferred Stock has a dividend rate of 7% per annum. All dividends will be paid in additional shares of Preferred Stock. At December 31, 2000, the Company paid dividends in the amount of \$98,965 in the form of additional shares of Series B Preferred Stock. At December 31, 2000, the number of common shares that would be issued upon conversion of the Series B Preferred Stock was 28,209,115.

In connection with the investment, Vulcan was permitted to appoint two members to the Company's Board of Directors. On February 28, 2000, Vulcan appointed William D. Savoy, President of Vulcan, and Edward S. Harris, Investment Analyst with Vulcan.

The Company is party to a joint venture with NSTAR Communications, Inc. ("NSTAR Communications"), a subsidiary of NSTAR, regarding construction of our Megaband™ Network and operation of our telecommunications business in the Boston metropolitan area. NSTAR is a holding company that, through its subsidiaries, provides regulated electric and gas utility services in the Boston area. Pursuant to the joint venture agreements, both parties have agreed to make capital contributions in accordance with their respective membership interests. In addition, the Company has access to and use of NSTAR's large fiber-optic network, rights-of-way and construction expertise. Pursuant to an exchange agreement between NSTAR Communications and the Company, NSTAR Securities has the right, from time to time, to convert portions of its ownership interest in RCN-BECOCOM into shares of the Company's Common Stock, based on an appraised value of such interest. Shares issued upon such exchanges are issued to NSTAR Securities. As of December 31, 2000, NSTAR Securities has exchanged portions of its interest for a total of 4,097,193 shares of the Company's Common Stock. Following such exchanges, NSTAR Securities retains a 23.14% sharing ratio in the joint venture, and the right to invest as if it owned a 49% interest. Such investment percentage will decrease to the extent NSTAR Securities disposes of any such Company Common Stock. In April 2000, NSTAR Securities gave notice of its intent to convert its remaining ownership interest into shares of the Company's Common Stock. In October 2000, the Company and NSTAR Communications reached an agreement in principle regarding settlement of the final valuation of that exchange and to amend certain other agreements governing the RCN-BECOCOM, LLC joint venture (the "Joint Venture"). If the transaction is consummated pursuant to the agreement in principle, NSTAR Securities would receive 7.5 million shares of the Company's Common Stock in exchange for its remaining membership interest in the Joint Venture, representing \$152 million invested by NSTAR Communications. In addition, a new class of security in the Joint Venture would be created. NSTAR Communications would be permitted to invest up to \$100 million in such security, which would carry a cash coupon rate of 1.84% per month, guaranteed by the Company. Such coupon would include amortization of principal, which would be fully amortized over a fifteen-year term (callable after eight years, subject to certain make-whole requirements). NSTAR Communications, at its election, may choose to designate the amounts it contributes under future capital calls as either common equity or the new security in the Joint Venture. Future investments by NSTAR Communications would not be convertible into Company stock. In addition, the Joint Venture and NSTAR Communications would amend certain of their agreements to incorporate an incentive and penalty provision for construction activities and expand the relevant market in which the Joint Venture operates. The parties have been continuing to discuss this agreement in principle and no assurance can be given that it will be consummated on the terms described above. RCN-BECOCOM is consolidated in our financial statements.

Sources of funding for the Company's further financing requirements may include vendor financing, public offerings or private placements of equity and/or debt securities, and bank loans. There can be no assurance that sufficient additional financing will continue to be available to the Company or, if available, that it can be obtained on a timely basis and on acceptable terms. Failure to obtain such financing could result

in the delay or curtailment of the Company's development and expansion plans and expenditures. Any of these events could impair the Company's ability to meet its debt service requirements and could have a material adverse effect on its business.

The Company has completed the following debt and equity offerings:

Date	Description	Proceeds	Maturity
October 1997	10% Senior Notes	\$225,000	October 5, 2007
October 1997	11.125% Senior Discount Notes	\$350,000	October 5, 2007
February 1998	9.8% Senior Discount Notes	\$350,587	February 15, 2008
June 1998	11% Senior Discount Notes	\$149,999	June 1, 2008
December 1999	10.125% Senior Notes	\$375,000	January 15, 2010

Date	Description/Price	Class/Series	Proceeds	Number of Shares
June 1998	Equity Offering	Common	\$112,866	6,098,355
April 1999	Equity Offering	Preferred A	\$239,897	250,000
May 1999	Equity Offering	Common	\$344,043	9,200,000
February 2000	Equity Offering	Preferred B	\$1,614,428	1,650,000

The Indentures for the Notes referred to above all contain similar provisions. The Chase Manhattan Bank acts as Trustee for each of the Indentures. All the aforementioned Notes are general senior unsecured obligations of the Company. The Senior Discount Notes do not bear cash interest for the first five years from the offering. Thereafter, cash interest on the notes will accrue at the respective interest rate per annum and will be payable semi-annually in arrears every six months.

The Senior Discount Notes are not callable for five years, and are redeemable in whole or in part, at any time on or after the fifth year, at the option of the Company. The Senior Notes are not callable for five years, and are redeemable in whole or in part, at any time on or after the fifth year, at the option of the Company. Both the Senior Discount Notes and the Senior Notes may be redeemed after year five at redemption prices starting at approximately 105% of the principal amount and declining to 100% of the principal amount, plus any accrued and unpaid interest.

The Company may, at its option, use the net proceeds of certain offerings of the Company's Common Stock to redeem up to an aggregate of 35% of the aggregate principal amount at maturity of the debt securities issued under the Indentures at a certain premium. Upon the occurrence of a change of control, the Company must make an offer to purchase all of the debt securities issued under the Indentures then outstanding at a premium.

The Indentures contain certain covenants that, among other things, limit the ability of the Company and its subsidiaries to incur indebtedness, pay dividends, prepay subordinated indebtedness, repurchase capital stock, engage in transactions with stockholders and affiliates, create liens, sell assets and engage in mergers and consolidations.

On April 7, 1999, Hicks, Muse, Tate & Furst, through Hicks Muse Fund IV, purchased 250,000 shares of Series A Preferred Stock, par value \$1 per share, for gross proceeds of \$250,000. The Series A Preferred Stock is convertible into Common Stock at any time and is subject to a mandatory redemption on March 31, 2014 at \$1.00 per share, plus accrued and unpaid dividends, but may be called by the Company after four years.

In connection with the investment, Hicks, Muse, Tate & Furst appointed Michael Levitt to the Company's Board of Directors. The Series A Preferred Stock is cumulative and has an annual dividend rate of 7% payable quarterly in cash or additional shares of Series A Preferred Stock and has a conversion price of \$39.00 per share. At December 31, 2000, we had paid cumulative dividends in the amount of \$31,955 in the form of additional Series A Preferred Stock. At December 31, 2000, the number of common shares that would be issued upon conversion of the Series A Preferred Stock was 7,229,615.

The Company and certain of its subsidiaries together (the "Borrowers") entered into a \$1,000,000 Senior Secured Credit Facility (the "Credit Facility") with the Chase Manhattan Bank and certain other lenders. The collateralized facilities are comprised of a \$250,000 seven-year revolving credit facility (the "Revolver"), a \$250,000 seven-year multi-draw term loan facility (the "Term Loan A") and a \$500,000 eight-year term loan facility (the "Term Loan B"). All three facilities are governed by a single credit agreement dated as of June 3, 1999 (the "Credit Agreement").

The Revolver may be borrowed and repaid from time to time. Up to \$150,000 of the Revolver may be used to fund working capital needs and for general corporate purposes. The remaining \$100,000 of the Revolver as well as the term loans may be used solely to finance telecommunications assets. The amount of the commitments under the Revolver automatically reduces to \$175,000 on June 3, 2005 and the remaining commitments are reduced quarterly in equal installments through to maturity at June 3, 2006. The Revolver can also be utilized for letters of credit up to a maximum of \$15,000. As of December 31, 2000, there were no letters of credit outstanding under the Revolver. As of December 31, 2000, the Company also had letters of credit outside the Revolver of approximately \$15,006.

The Term Loan A is available for drawing until December 3, 2001, at which time any undrawn commitments expire. At December 31, 2000, there were no outstanding loans under the Term Loan A. Any outstanding borrowings under the Term Loan A at September 3, 2002 will be repaid in quarterly installments based on percentage increments of the Term Loan A that start at 3.75% per quarter on September 3, 2002 and increase in steps to a maximum of 10% per quarter on September 3, 2005 through to maturity at June 3, 2006.

As of December 31, 2000, \$500,000 of the Term Loan B was outstanding. The Term Loan B was fully drawn at closing. Amortization of the Term Loan B starts on September 3, 2002 with quarterly installments of \$1,000 per quarter until September 3, 2006 when the quarterly installments increase to \$121,000 per quarter through to maturity at June 3, 2007.

The interest rate on the Credit Facility is, at the election of the Borrowers, based on either a LIBOR or an alternate base rate. For a Revolver or Term Loan A borrowing, the interest rate will be LIBOR plus a spread of up to 300 basis points or the base rate plus a spread of 200 basis points, depending upon financial covenant calculations. In the case of the Revolver and the Term Loan A, a fee of 125 basis points on the unused commitment accrues until the Company's earnings before income tax, depreciation and amortization ("EBITDA") has become positive and thereafter at up to 125 basis points depending upon the Company's utilization of the commitments. For all Term Loan B borrowings the interest includes a spread that is fixed at 350 basis points over the LIBOR or 250 basis points over the alternate base rate.

The Credit Agreement contains conditions precedent to borrowing, events of default (including change of control) and covenants customary for facilities of this nature. The Credit Facility is secured by substantially all of the assets of the Company and its subsidiaries.

Prepayments of the eight-year term loan require payment of a fee of 2% of the amount of such prepayment if made on or prior to June 3, 2000 and 1% of such prepayment if made thereafter but on or prior to June 3, 2001.

The foregoing summary of certain provisions of the Credit Agreement does not purport to be complete and is subject to, and qualified in its entirety by reference to, the Credit Agreement including the amendment thereto.

The Company has indebtedness that is substantial in relation to its shareholders' equity and cash flow. At December 31, 2000, the Company had an aggregate of approximately \$2,258,000 of indebtedness outstanding, and the ability to borrow up to an additional \$500,000 under the Credit Agreement. The Company also has cash, temporary cash investments and short-term investments aggregating approximately \$1,723,000 and a current ratio of approximately 3.49:1.

As a result of the substantial indebtedness of the Company, the Company's fixed charges are expected to exceed its earnings for the foreseeable future. The leveraged nature of the Company could limit its ability to effect future financing or may otherwise restrict the Company's business activities.

The extent of the Company's leverage may have the following consequences: (i) limit the ability of the Company to obtain necessary financing in the future for working capital, capital expenditures, debt service requirements or other purposes; (ii) require that a substantial portion of the Company's cash flows from operations be dedicated to the payment of principal and interest on its indebtedness and therefore not be available for other purposes; (iii) limit the Company's flexibility in planning for, or reacting to, changes in its business; (iv) place the Company at a competitive disadvantage as compared with less leveraged competitors; and (v) render the Company more vulnerable in the event of a downturn in its business.

The objective of the Company's "other than trading portfolio" is to invest in high-quality securities, to preserve principal, meet liquidity needs, and deliver a suitable return in relationship to these guidelines.

For the year ended December 31, 2000, the Company's net cash used in operating activities was \$261,422 comprised primarily of a net loss of (\$768,714) adjusted by non-cash depreciation and amortization of \$285,647, other non-cash items totaling \$159,264, a write-down of an equity investment of \$24,413 and working capital changes of \$37,963. Net cash used in investing activities of \$1,471,331 consisted primarily of additions to property, plant and equipment of \$1,127,869, acquisitions of \$316,074, short-term investments, net of (\$49,784), and investment and advances in unconsolidated joint venture of \$64,647. Net cash provided by financing activities of \$1,697,718 included proceeds from the issuance of Preferred Stock of \$1,614,423, contribution from minority interest partner of \$61,005 and proceeds from the exercise of stock options of \$6,625.

■ Effective Recently Issued Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board ("FASB") issued SFAS No. 138, "Accounting for Certain Derivative Instruments and for Certain Hedging Activities." This Statement establishes accounting and reporting standards requiring that every derivative instrument be recorded on the balance sheet as either an asset or liability measured at fair value. SFAS 138 requires that changes in a derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. As the Company does not have significant derivative financial instruments, the Company does not expect the adoption of SFAS 138 to have a material impact on its reported earnings and/or other comprehensive income.

■ Quantitative & Qualitative Disclosures About Market Risk

The Company has adopted Item 305 of Regulation S-K, "Quantitative & Qualitative Disclosures About Market Risk," which is effective in financial statements for fiscal years ending after June 15, 1998. The Company currently has no items that relate to "trading portfolios." Under the "other than trading portfolios" the Company does have short-term investment portfolios categorized as available for sale securities that are stated at cost, which approximates market, and which are re-evaluated at each balance sheet date and one portfolio that is categorized as held to maturity which is an escrow account against a defined number of future interest payments related to the Company's 10% Senior Discount Notes. These portfolios consist of Federal Agency Notes, Commercial Paper, Corporate Debt Securities, Certificates of Deposit, U.S. Treasury Notes, and Asset Backed Securities. The Company believes there is limited exposure to market risk due primarily to the small amount of market sensitive investments that have the potential to create material market risk. Furthermore, the Company's internal investment policies have set maturity limits, concentration limits, and credit quality limits to minimize risk and promote liquidity. The Company did not include trade accounts payable and trade accounts receivable in the "other than trading portfolio" because their carrying amounts approximate fair value.

The objective of the Company's "other than trading portfolio" is to invest in high-quality securities and seeks to preserve principal, meet liquidity needs, and deliver a suitable return in relationship to these guidelines. The Company may from time to time enter into interest rate protection agreements.

Consolidated Statements of Operations

(Thousands of Dollars, Except Share and Per Share Data)

For the Years Ended December 31,	2000	1999	1998
Sales	\$ 333,450	\$ 275,993	\$ 210,940
Costs and expenses, excluding non-cash stock-based compensation, depreciation and amortization	665,409	407,960	262,352
Non-cash stock-based compensation	41,237	—	—
Depreciation and amortization	285,648	146,043	89,088
Acquired in-process research and development	—	—	18,293
Operating (loss)	(658,844)	(278,010)	(158,793)
Interest income	140,159	76,786	58,679
Interest expense	(223,868)	(158,139)	(112,239)
Gain on sale of subsidiary	—	8,930	—
Write-down of equity investment	(24,418)	—	—
Other (expense) income, net	3,461	(3,567)	(1,889)
(Loss) before income taxes	(763,510)	(354,000)	(214,242)
(Benefit) for income taxes	(4,778)	(5,094)	(4,998)
(Loss) before equity in unconsolidated entities and minority interest	(758,732)	(348,906)	(209,244)
Equity in (loss) of unconsolidated entities	(34,497)	(33,960)	(12,719)
Minority interest in loss of consolidated entities	24,515	28,262	17,162
(Loss) before extraordinary item and cumulative effect of change in accounting principle	(768,714)	(354,604)	(204,801)
Extraordinary item—debt prepayment costs, net of tax	—	(424)	—
Cumulative effect of change in accounting for start-up costs, net of tax	—	—	(641)
Net (loss)	(768,714)	(355,028)	(205,442)
Preferred stock dividend and accretion requirements	122,752	13,542	—
Net (loss) to common shareholders	\$ (891,466)	\$(368,570)	\$(205,442)
Basic and diluted loss per average common share:			
(Loss) before extraordinary item and cumulative effect of change in accounting principle	\$ (10.59)	\$ (5.11)	\$ (3.35)
Extraordinary item—debt prepayment costs	\$ —	\$ (0.01)	\$ —
Cumulative effect of change in accounting for start-up costs	\$ —	\$ —	\$ (0.01)
Net (loss)	\$ (10.59)	\$ (5.12)	\$ (3.36)
Weighted average shares outstanding	84,200,329	71,966,301	61,187,354

See accompanying notes to Consolidated Financial Statements.

Consolidated Balance Sheets

(Thousands of Dollars, Except Share and Per Share Data)

December 31,	2000	1999
Assets		
Current assets		
Cash and temporary cash investments	\$ 356,377	\$ 391,412
Short-term investments	1,372,015	1,401,877
Accounts receivable from related parties	37,874	8,015
Accounts receivable, net of reserve for doubtful accounts of \$4,123 in 2000 and \$12,258 in 1999	50,681	28,434
Interest receivable	13,365	15,049
Unbilled revenues	2,197	2,124
Prepayments and other	21,822	13,853
Investments restricted for debt service	—	23,111
Total current assets	1,854,331	1,883,875
Property, plant and equipment, net of accumulated depreciation of \$420,659 in 2000 and \$230,581 in 1999	2,255,959	914,243
Investments restricted for debt service	—	48
Investments	204,946	190,571
Intangible assets, net of accumulated amortization of \$274,924 in 2000 and \$158,384 in 1999	389,672	138,491
Deferred charges and other assets	70,644	64,886
Total assets	\$ 4,775,552	\$3,192,114

Consolidated Balance Sheets (continued)

(Thousands of Dollars, Except Share and Per Share Data)

December 31,	2000	1999
Liabilities and Shareholders' Equity		
Current liabilities		
Current maturities of long-term debt and capital lease obligations	\$ 355	\$ 1,225
Accounts payable to related parties	89,800	35,809
Accounts payable	198,562	92,785
Advance billings and customer deposits	24,638	16,901
Accrued interest	29,837	13,090
Accrued cost of sales	43,298	18,296
Deferred income taxes	—	1,464
Accrued expenses	144,399	69,875
Total current liabilities	530,889	249,445
Long-term debt	2,257,357	2,143,096
Other deferred credits	25,983	24,598
Minority interest	75,232	129,234
Commitments and contingencies		
Redeemable preferred stock, par value \$1 per share:		
Authorized 25,000,000 shares: 2,030,919		
and 263,053 shares issued and outstanding in 2000 and 1999, respectively	1,990,613	253,438
Common shareholders' (deficit) equity:		
Common Stock, par value \$1 per share: Authorized 100,000,000 shares:		
Issued 87,104,229 and 77,724,070 shares		
in 2000 and 1999, respectively	87,104	77,724
Additional paid-in capital	1,325,018	923,340
Cumulative translation adjustments	(6,695)	(2,014)
Unearned compensation expense	(25,889)	—
Unrealized appreciation/(depreciation) on investments	8,125	(6,228)
Treasury stock, 564,629 and 562,000 shares		
at cost in 2000 and 1999, respectively	(9,591)	(9,391)
Accumulated deficit	(1,482,594)	(591,128)
Total common shareholders' (deficit) equity	(104,522)	392,303
Total liabilities, redeemable preferred and common shareholders' (deficit) equity	\$ 4,775,552	\$3,192,114

See accompanying notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows

(Thousands of Dollars)

For the Years Ended December 31,	2000	1999	1998
Cash flows from operating activities			
Net (loss)	\$ (768,714)	\$ (355,028)	\$ (205,442)
Accretion of discounted debt	112,997	101,901	80,925
Amortization of financing costs	8,713	5,534	2,816
Acquired in-process research and development	—	—	18,293
Non-cash stock-based compensation expense	41,237	—	—
Gain on sale of investment	—	(8,621)	—
Extraordinary item—debt prepayment penalty	—	424	—
Depreciation and amortization	285,648	146,043	89,088
Deferred income taxes, net	(782)	(9,270)	(6,147)
Provision for losses on accounts receivable	10,908	7,691	4,125
Equity in loss of unconsolidated entities	34,497	33,960	12,719
Minority interest	(24,516)	(28,262)	(17,162)
Write-down of equity investment	24,418	—	—
Net change in certain assets and liabilities, net of business acquisitions:			
Accounts receivable and unbilled revenues	(29,615)	(22,353)	3,500
Accounts payable	78,342	59,950	28,456
Accrued expenses	109,670	25,943	37,446
Accounts receivable from related parties	(29,859)	(1,096)	2,910
Accounts payable to related parties	53,991	2,179	3,405
Unearned revenue, advance billing and customer deposits	8,032	(2,659)	(17,629)
Other	(23,790)	(15,592)	(1,084)
Net cash (used in)/provided by operating activities	(108,824)	(59,256)	36,219
Cash flows from investing activities:			
Additions to property, plant and equipment	(1,127,869)	(526,240)	(285,867)
Additions to construction material	(152,598)	(17,124)	(1,109)
Short-term investments, net	49,784	(513,995)	(474,606)
Acquisitions, net of cash acquired	(316,074)	(53,322)	(47,361)
Investment in unconsolidated joint venture	(64,647)	(25,439)	(20,000)
Advance to unconsolidated entity	(12,000)	—	—
Purchase of preferred stock	(750)	(1,500)	—
Proceeds from sale of investment	—	23,711	—
Other	225	(108)	(342)
Net cash (used in) investing activities	(1,623,929)	(1,113,017)	(829,285)

Consolidated Statements of Cash Flows (continued)

(Thousands of Dollars)

For the Years Ended December 31,	2000	1999	1998
Cash flows from financing activities			
Repayment of long-term debt and capital leases	(4,423)	(101,622)	(7,770)
Issuance of long-term debt	—	875,000	502,587
Proceeds from the issuance of stock	1,614,423	584,239	112,866
Purchase of treasury stock	(200)	(90)	(9,301)
Contribution to minority interest partner	—	(122)	(108)
Extraordinary item—debt prepayment penalty	—	(424)	—
Payments made for debt financing costs	(2,823)	(39,484)	(10,185)
Cash contribution from minority interest partner	61,005	91,140	77,849
Decrease related to investments			
restricted for debt service	23,111	22,500	22,375
Proceeds from the exercise of stock options	6,625	12,422	1,969
Net cash provided by financing activities	1,697,718	1,443,559	690,282
Net increase (decrease) in cash and temporary cash investments	(35,035)	271,286	(102,784)
Cash and temporary cash investments at beginning of year	391,412	120,126	222,910
Cash and temporary cash investments at end of year	\$ 356,377	\$ 391,412	\$120,126
Supplemental disclosures of cash flow information			
Cash paid during the periods for:			
Income taxes	\$ 228	\$ 1,897	\$ 1,047
Interest (net of \$8,330 and \$5,126 capitalized in 2000 and 1999, respectively)	\$ 87,543	\$ 42,880	\$ 28,781

See accompanying notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows (continued)

(Thousands of Dollars)

Supplemental Schedule of Non-Cash Investing and Financing Activities

In December 2000, the Company completed the acquisition of certain assets of Wedgewood Communications for approximately \$14,600.

In September 2000, the Company completed the acquisition of certain assets of Onepoint Communications for approximately \$7,700.

In April 2000, the Company completed the acquisition of 21st Century Telecom Group, Inc. The transaction was accounted for as a purchase.

A summary of the transaction is as follows:

Fair value of assets acquired	\$556,361
Less:	
Fair value of the Company's stock issued	208,510
Fair value of stock options exchanged	2,489
Liabilities assumed	35,755
Cash acquired	<u>15,065</u>
Net cash paid	<u>\$294,542</u>

In February 2000, NSTAR Securities exchanged a portion of its ownership interest in RCN-BECOCOM for 2,989,654 shares of the Company's Common Stock, with a fair value of approximately \$127,150.

Preferred stock dividends in the form of additional shares of redeemable preferred stock aggregated \$117,867 and \$13,053 in 2000 and 1999, respectively.

Non-cash accretion of preferred stock was \$4,885 and \$489 in 2000 and 1999, respectively.

In August 1999, the Company completed the acquisition of Direct Network Access, Ltd. The transaction was accounted for as a purchase.

A summary of the transaction is as follows:

Fair value of assets acquired	\$ 11,416
Less:	
Fair value of the Company's stock issued	6,844
Liabilities assumed	<u>1,107</u>
Net cash paid	<u>\$ 3,465</u>

In July 1999, the Company completed the acquisition of Brainstorm Networks, Inc. The transaction was accounted for as a purchase.

A summary of the transaction is as follows:

Fair value of assets acquired	\$ 15,785
Less:	
Fair value of the Company's stock issued	11,619
Liabilities assumed	<u>1,850</u>
Net cash paid	<u>\$ 2,316</u>

Consolidated Statements of Cash Flows (continued)

(Thousands of Dollars)

In April 1999, the Company acquired a 47.5% stake in JuniorNet. The Company purchased the ownership stake for approximately \$47,000.

In February 1999, NSTAR Securities exchanged a portion of its ownership interest in RCN-BECOCOM for 1,107,539 shares of the Company's Common Stock, with a fair value of approximately \$19,520.

In February 1998, the Company completed the acquisition of Erols Internet, Inc. The transaction was accounted for as a purchase.

A summary of the transaction is as follows:

Fair value of assets acquired	\$147,000
Less:	
Fair value of the Company's stock issued	(45,000)
Fair value of stock options exchanged	(11,000)
Liabilities assumed	<u>(55,000)</u>
Net cash paid (including out of pocket expenses of approximately \$1,400 and repayment of debt of approximately \$5,100)	\$ 36,000

The Company contributed to Starpower approximately 60% of the subscribers and related unearned revenue acquired in the acquisition of Erols.

In February 1998, the Company completed the acquisition of UltraNet. The transaction was accounted for as a purchase.

A summary of the transaction is as follows:

Fair value of assets acquired	\$ 41,500
Less:	
Fair value of the Company's stock issued	(26,200)
Fair value of stock options exchanged	(1,900)
Liabilities assumed	<u>(5,700)</u>
Net cash paid	\$ 7,700

In June 1998, the Company completed the acquisition of Interport Communications, Corp. The transaction was accounted for as a purchase.

A summary of the transaction is as follows:

Fair value of assets acquired	\$ 11,000
Less:	
Fair value of the Company's stock issued	(8,500)
Liabilities assumed	<u>(1,200)</u>
Net cash paid	\$ 1,300

Consolidated Statements of Cash Flows (continued)

(Thousands of Dollars)

In June 1998, the Company completed the acquisition of Lancit Media Entertainment, Ltd. The transaction was accounted for as a purchase.

A summary of the transaction is as follows:

Fair value of assets acquired	\$ 14,800
Less:	
Fair value of the Company's stock issued	(7,400)
Liabilities assumed	<u>(7,000)</u>
Net cash paid	<u>\$ 400</u>

In July 1998, the Company completed the acquisition of JavaNet, Inc. The transaction was accounted for as a purchase.

A summary of the transaction is as follows:

Fair value of assets acquired	\$ 21,800
Less:	
Fair value of the Company's stock issued	(13,400)
Liabilities assumed	<u>(4,700)</u>
Net cash paid	<u>\$ 3,700</u>

See accompanying notes to Consolidated Financial Statements.

Consolidated Statements of Changes in Common Shareholders' Equity/(Deficit)

For the Years Ended December 31, 2000, 1999 and 1998
(Thousands of Dollars, Except Share and Per Share Data)

	Common Stock	Additional Paid-in Capital	Accumulated Deficit
Balance, December 31, 1997	\$54,989	\$ 321,766	\$ (17,116)
Net loss			(205,442)
Common Stock offering	6,099	106,767	
Stock plan transactions	436	2,001	
Common Stock and stock options issued in connection with acquisitions	3,953	109,258	
Purchase of treasury stock			
Unrealized appreciation on investments			
Other		(22)	
Balance, December 31, 1998	\$65,477	\$ 539,770	\$ (222,558)
Net loss to common shareholders			(368,570)
Common Stock offering	9,200	335,142	
Stock plan transactions	1,466	10,956	
Conversion of joint venture ownership interest	1,108	18,413	
Common Stock and stock options issued in connection with acquisitions	467	18,852	
Purchase of treasury stock			
Unrealized depreciation on investments			
Cumulative translation adjustment			
Other	6	207	
Balance, December 31, 1999	\$77,724	\$ 923,340	\$ (591,128)
Net loss to common shareholders			(891,466)
Stock plan transactions	1,141	71,769	
Recognition of unearned compensation			
Conversion of joint venture ownership interest	2,990	124,159	
Common Stock and stock options issued in connection with acquisitions	5,249	205,750	
Purchase of treasury stock			
Unrealized appreciation on investments			
Cumulative translation adjustment			
Other			
Balance, December 31, 2000	\$87,104	\$1,325,018	\$(1,482,594)

See accompanying notes to Consolidated Financial Statements.

Consolidated Statements of Changes in Common Shareholders' Equity/(Deficit) (continued)

For the Years Ended December 31, 2000, 1999 and 1998
(Thousands of Dollars, Except Share and Per Share Data)

	Treasury Stock	Unearned Compensation Expense	Cumulative Translation Adjustment	Unrealized Appreciation/ Depreciation on Investments	Total Common Shareholders' Equity/(Deficit)
Balance, December 31, 1997	\$ —	\$ —	\$(3,055)	\$ —	\$ 356,584
Net loss					(205,442)
Common Stock offering					112,866
Stock plan transactions					2,437
Stock and stock options issued in connection with acquisitions				—	113,211
Purchase of treasury stock	(9,301)				(9,301)
Unrealized appreciation on investments				1,113	1,113
Other					(22)
Balance, December 31, 1998	\$(9,301)	\$ —	\$(3,055)	\$ 1,113	\$ 371,446
Net loss to common shareholders					(368,570)
Common Stock offering					344,342
Stock plan transactions					12,422
Conversion of joint venture ownership interest					19,521
Common Stock issued in connection with acquisitions					19,319
Purchase of treasury shares	(90)				(90)
Unrealized depreciation on investments				(7,341)	(7,341)
Cumulative translation adjustment			1,041		1,041
Other					213
Balance, December 31, 1999	\$(9,391)	\$ —	\$(2,014)	\$(6,228)	\$ 392,303
Net loss to common shareholders					(891,466)
Stock plan transactions		(37,941)			34,969
Recognition of unearned compensation		12,052			12,052
Conversion of joint venture ownership interest					127,149
Common Stock issued in connection with acquisitions					210,999
Purchase of treasury stock	(200)				(200)
Unrealized appreciation on investments				14,353	14,353
Cumulative translation adjustment			(4,681)		(4,681)
Other					
Balance, December 31, 2000	\$(9,591)	\$(25,889)	\$(6,695)	\$ 8,125	\$(104,522)

See accompanying notes to Consolidated Financial Statements.

Consolidated Statements of Changes in Common Shareholders' Equity/(Deficit) (continued)

For the Years Ended December 31, 2000, 1999 and 1998
(Thousands of Dollars, Except Share and Per Share Data)

	Common Shares Issued	Treasury Stock	Shares Outstanding
Balance, December 31, 1997	54,989,870	—	54,989,870
Common Stock offering	6,098,355		6,098,355
Stock plan transactions	436,342		436,342
Common Stock issued in connection with acquisitions	3,952,926		3,952,926
Purchase of treasury stock		(557,000)	(557,000)
Balance, December 31, 1998	65,477,493	(557,000)	64,920,493
Preferred stock offering			
Preferred stock dividend			
Common Stock offering	9,200,000		9,200,000
Stock plan transactions	1,518,897		1,518,897
Conversion of joint venture ownership interest	1,107,539		1,107,539
Common Stock issued in connection with acquisitions	420,141		420,141
Purchase of treasury stock		(5,000)	(5,000)
Balance, December 31, 1999	77,724,070	(562,000)	77,162,070
Preferred stock offering			
Preferred stock dividend			
Common Stock offering			
Stock plan transactions	1,141,405		1,141,405
Conversion of joint venture ownership interest	2,989,654		2,989,654
Common Stock issued in connection with acquisitions	5,249,100		5,249,100
Purchase of treasury stock		(2,629)	(2,629)
Balance, December 31, 2000	87,104,229	(564,629)	86,539,600

See accompanying notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

(Thousands of Dollars, Except Share and Per Share Data)

1 Background and Basis of Presentation

RCN Corporation (the “Company” or “RCN”) is primarily in the business of delivering bundled communications services to residential customers over our own network to 7 of the 10 most densely populated areas of the country, as well as other areas. We are currently operating in Boston, New York, Philadelphia suburbs, Washington, D.C., Chicago, San Francisco and Los Angeles.

ResiLinkSM is the brand name of our bundled service that enables residential customers to enjoy a bundle of Phone, Cable TV and High-Speed Internet for a flat monthly price. The bundles are designed to appeal to consumers seeking simplification and value. In addition to ResiLinkSM, we sell Phone, Cable TV and dial-up Internet to residential customers on an a-la-carte basis, and we provide communications services to commercial customers. We are working to leverage the excess capacity of our MegabandTM Network to allow us to expand our offering of new services.

Our services are delivered over our own high-speed, high capacity, fiber-optic MegabandTM Network. We are building our MegabandTM Network in the most densely populated areas of the nation, which gives us access to 44% of the residential telecommunications market by building our network in only 6% of the nation’s geography. We generally build our MegabandTM Network in communities where we can reach 150 homes per mile of network plant. By comparison, the average density level of the cable incumbents and the phone incumbents is 38 and 26 homes per mile of plant, respectively (Source: The Yankee Group). The MegabandTM Network is a unique broadband fiber-optic platform that employs SONET ring backbone architecture and localized nodes. This architecture allows us to bring our state-of-the-art fiber-optics to travel within approximately 900 feet of our customers, with fewer electronics and lower maintenance costs than existing competitors’ local networks. We have designed our MegabandTM Network to have significant excess capacity so that we believe we have the capability of adding new communications services more efficiently and effectively than the incumbents or other competitors could manage.

The consolidated financial statements include the accounts of all wholly-owned subsidiaries. All material intercompany transactions and balances have been eliminated. The RCN-BECOCOM joint venture which the Company controls and in which the minority investors do not possess significant veto rights is consolidated. The Starpower, Megacable and JuniorNet investments are accounted for by the equity method.

2 Summary of Significant Accounting Policies

Use of Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Temporary Cash Investments For purposes of reporting cash flows, the Company considers all highly liquid investments purchased with an original maturity of three months or less to be temporary cash investments. Temporary cash investments are stated at market value.

Short-Term Investments and Investments Restricted for Debt Service Management determines the appropriate classification of its investments in debt and equity securities at the time of purchase and reevaluates such determination at each balance sheet date in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 115—“Accounting for Certain Investments in Debt and Equity Securities.” At December 31, 2000 and 1999, marketable debt and equity securities have been cate-

gorized as available for sale. The Company states its short-term investments at market value. Investments restricted for debt service have been categorized as held to maturity since management has the positive intent and ability to hold such securities to maturity.

Property, Plant and Equipment and Depreciation Property, plant and equipment reflects the original cost of acquisition or construction, including related payroll and costs such as taxes, fringe benefits, and certain general administrative costs.

Depreciation is provided on the straight-line method based on the useful lives of the various classes of depreciable property. The average estimated lives of depreciable property, plant and equipment are:

	Lives
Telecommunications network	5–22.5 years
Computer equipment	3–5 years
Buildings and leasehold improvements	5–30 years
Furniture, fixtures and vehicles	3–10 years
Other	5–10 years

Repairs of all property, plant and equipment and minor replacements and renewals are charged to expense as incurred. Major replacements and betterments are capitalized. Gain or loss is recognized on retirements and dispositions.

Intangible Assets Intangible assets are valued at cost and are amortized on a straight-line basis over the expected period of the benefit ranging from 1 to 14 years. The average estimated useful lives of intangible assets are:

	Lives
Franchises and subscriber lists	5–10 years
Acquired current products/technologies	4 years
Non-compete agreements	2–8 years
Goodwill	4–10 years
Building access rights	3–14 years
Other intangible assets	1–10 years

Revenue Recognition Local telephone service revenue is recorded as earned based on tariffed rates. Long distance telephone service revenue is recorded based on minutes of traffic processed and tariffed rates or contracted fees. Revenues from cable programming services are recorded in the month the service is provided. Internet access service revenues are recorded based on contracted fees.

Advertising Expense Advertising costs are expensed as incurred. Advertising expense charged to operations was \$34,986, \$34,865 and \$28,841 in 2000, 1999 and 1998, respectively.

Debt Issuance Costs Debt Issuance Costs are amortized over the life of the note. Amortization expense related to Debt Issuance Costs charged to operations were \$8,713, \$5,534 and \$2,816 in 2000, 1999 and 1998, respectively.

Stock-Based Compensation As of January 1, 2000, the Company has adopted the recognition provisions of Statement of Financial Accounting Standards ("SFAS") No. 123—"Accounting for Stock-Based Compensation" ("SFAS 123"). Under SFAS 123, the fair value of an option on the date of the grant is amortized over the vesting periods of the options in accordance with Financial Accounting Standards Board ("FASB") Interpretation No. 28—"Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans" ("FIN 28"). The recognition provisions of SFAS 123 are applied prospectively upon adoption. As a result, the recognition provisions are applied to all stock awards granted in the year of adoption and are not applied to awards granted in previous years unless those awards are significantly modified. The adoption of SFAS 123 resulted in non-cash charges to operations of \$41,237 in 2000. The Company applied Accounting Principles Board Opinion No. 25—"Accounting for Stock Issued to Employees" ("APB 25") in accounting for its stock options, prior to January 1, 2000.

Income Taxes Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled.

Foreign Currency Translation At December 31, 2000, the Company has a 48.96% interest in Megacable. Beginning January 1, 1999, the Company discontinued highly inflationary accounting for our Megacable investment and resumed using the Mexican peso as the functional currency. As a result, the Company's equity is affected by the translation from the Mexican peso. For 1998, the Company considered Megacable to operate in a highly inflationary economy due to the three-year cumulative rate of inflation at December 31, 1997 exceeding 100%. As a result, the financial statements of Megacable were remeasured as if the functional currency were the U.S. dollar. The remeasurement of the Mexican peso into U.S. dollars creates translation adjustments which were included in net income. The Company's proportionate share of gains and losses resulting from transactions of Megacable, which are made in currencies different from its own, are included in income as they occur. For purposes of determining its equity in the earnings of Megacable, the Company translates the revenues and expenses of Megacable into U.S. dollars at the average exchange rates that prevail during the period. The Company's proportionate share of such adjustments was (\$4,681) and \$1,041 for the years ended December 31, 2000 and 1999, respectively. Assets and liabilities are translated into U.S. dollars at the rates in effect at the end of the fiscal period.

Comprehensive Income The Company primarily has two components of comprehensive income, cumulative translation adjustments and unrealized appreciation (depreciation) on investments: the cumulative foreign currency translation adjustment was (\$4,681) for 2000, \$1,041 for 1999 and unchanged for 1998; the unrealized appreciation (depreciation) on investments was \$14,353 for 2000, (\$7,341) for 1999 and \$1,113 for 1998. The amount of other comprehensive loss for the years ended December 31, 2000, 1999 and 1998 was (\$759,042), (\$361,328) and (\$204,329), respectively.

Accounting Pronouncements In June 1998, the Financial Accounting Standards Board ("FASB") issued SFAS No. 133, "Accounting for Derivative Instruments and for Hedging Activities." This Statement establishes accounting and reporting standards requiring that every derivative instrument be recorded on the balance sheet as either an asset or liability measured at fair value. FASB 133 requires that changes in a derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met and is effective for fiscal years beginning after June 15, 2000. As the Company does not have significant derivative financial instruments, the adoption of SFAS 133 did not have a material impact on reported earnings and/or other comprehensive income.

Segment Disclosure The Company adopted Statement of Financial Accounting Standards No. 131 — "Disclosures about Segments of an Enterprise and Related Information" ("SFAS 131"), which became effective December 15, 1997. Management believes that the Company operates as one reportable operating segment, which contains many shared expenses generated by the Company's various revenue streams and that any segment allocation of shared expenses incurred on a single network to multiple revenue streams would be impractical and arbitrary; furthermore, the Company currently does not make such allocations internally. The Company's chief decision-makers do, however, monitor financial performance in a way which is different from that depicted in the historical general purpose financial statements in that such measurement includes the consolidation of all joint ventures, including Starpower, which is not consolidated under generally accepted accounting principles. Such information, however, does not represent a separate segment under generally accepted accounting principles and therefore it is not separately disclosed.

Risks and Uncertainties Our future results of operations involve a number of risks and uncertainties. Factors that could affect future operating results and cause actual results to vary materially from historical results include, but are not limited to, dependence upon acceptance of fiber-optic technology as the platform of choice, difficulties that may be encountered in competing in the highly competitive telecommunications industry, dependence on our strategic relationships and joint ventures, our limitations of our business flexibility due to our substantial indebtedness and the competitive market from the incumbent providers which are already established and have historically dominated their markets.

Reporting Format Certain items related to 1999 and 1998 have been restated to conform with the 2000 reporting format.

3 Earnings Per Share Basic earnings per share is computed based on-net (loss) after preferred stock dividend and accretion requirements divided by the weighted average number of shares of Common Stock outstanding during the period.

Diluted earnings per share is computed based on-net (loss) after preferred stock dividend and accretion requirements divided by the weighted average number of shares of Common Stock outstanding during the period after giving effect to convertible securities considered to be dilutive Common Stock equivalents. The conversion of preferred stock and stock options during the periods in which the Company incurs a loss from continuing operations is not assumed since the effect is anti-dilutive. The number of shares of preferred stock and stock options which would have been assumed to be converted in the years ended December 31, 2000, 1999, and 1998 and have a dilutive effect if the Company had income from continuing operations is 38,269,575, 10,008,239 and 3,198,493, respectively.

The following table is a reconciliation of the numerators and denominators of the basic and diluted per share computations:

Years Ended December 31,	2000	1999	1998
(Loss) before extraordinary item and cumulative effect of change in accounting principle	\$(768,714)	\$(354,604)	\$(204,801)
Preferred stock dividend and accretion requirements	(122,752)	(13,542)	—
	\$(891,466)	\$(368,146)	\$(204,801)
Basic (loss) per average common share:			
Weighted average shares outstanding	84,200,329	71,996,301	61,187,354
(Loss) per average common share before extraordinary item and cumulative effect of change in accounting principle	\$ (10.59)	\$ (5.11)	\$ (3.35)
Diluted (loss) per average common share:			
Weighted average shares outstanding	84,200,329	71,996,301	61,187,354
	84,200,329	71,996,301	61,187,354
(Loss) per average common share before extraordinary item and cumulative effect of change in accounting principle	\$ (10.59)	\$ (5.11)	\$ (3.35)

4 Business Combinations

The company entered into the following business combinations and were all accounted for by the purchase method of accounting.

In November 2000, the Company acquired certain assets of Wedgewood Communications for approximately \$14,250 in cash. The excess of the book value of assets acquired was recorded as goodwill and is being amortized over approximately four years.

In September 2000, the Company acquired certain assets of Onepoint Communications for approximately \$7,300 in cash. The excess of the book value of assets acquired was recorded as goodwill and is being amortized over approximately four years.

In April 2000, the Company acquired 21st Century Telecom Group, Inc. The Company purchased 21st Century for approximately \$294,500 in cash and shares of Common Stock with a fair value at the time of issuance of approximately \$211,000. Additionally, the purchase price includes approximately \$2,500 representing the fair value of 21st Century stock options which were converted to the Company's stock options in connection with the acquisition.

Although the final valuation of the acquisition is not yet complete, goodwill of approximately \$303,599 was recorded in connection with the acquisition of 21st Century and is being amortized over approximately four years.

In August 1999, the Company acquired Direct Network Access, Ltd. ("DNAI"). The Company acquired DNAI for approximately \$3,450 in cash and shares of Common Stock with a fair value at the time of issuance of approximately \$6,850. Such goodwill is being amortized over approximately four years.

In July 1999, the Company acquired Brainstorm Networks, Inc. ("Brainstorm"), a leading independent Internet Service Provider that provides dedicated and DSL services. The Company purchased Brainstorm for approximately \$2,900 in cash and shares of Common Stock with a fair value at the time of issuance of approximately \$11,600. The Company does not expect these acquisitions to have a material Pro forma effect on its financial position or results of operations. Such goodwill is being amortized over approximately four years.

In July 1998, the Company acquired Javanet, Inc. ("Javanet"). The consideration was \$3,700 in cash and the Company's Common Stock with a fair value of approximately \$13,400 at the time of issuance. The transaction was accounted for by the purchase method of accounting. Approximately \$14,800 has been allocated to goodwill. Such goodwill is being amortized over approximately three years.

In June 1998, the Company acquired Interport Communications Corp. ("Interport"). The total approximate consideration for the transaction was \$1,300 in cash and the Company's Common Stock with a fair value of approximately \$8,500 at the time of issuance. The transaction was accounted for by the purchase method of accounting. Approximately \$7,200 has been allocated to goodwill. Such goodwill is being amortized over approximately four years.

In June 1998, the Company acquired Lancit Media Entertainment, Ltd. ("Lancit"), a producer of high-quality children's programming. The total approximate consideration for the transaction was \$400 in cash and the Company's Common Stock with a fair value of approximately \$7,400 at the time of issuance. The transaction was accounted for by the purchase method of accounting. Approximately \$9,500 has been allocated to goodwill. Such goodwill is being amortized over approximately five years.

In February 1998, the Company acquired Erols Internet, Inc. ("Erols"). The total approximate consideration was \$36,000 in cash including out-of-pocket costs of approximately \$1,400 and the assumption and repayment of debt of approximately \$5,100 and the Company's Common Stock with a fair value of approximately \$45,000 at the time of issuance. Additionally, the purchase price includes approximately \$11,000 representing the fair value of Erols stock options which were converted to the Company's stock options in connection with the acquisition. The transaction was accounted for by the purchase method of accounting.

The Company contributed to Starpower approximately 60% of the subscribers and related unearned revenue acquired in the acquisition of Erols.

Goodwill and the value assigned to certain acquired current products and technologies, primarily residential dial-up and dedicated Internet access, and Internet advertising of approximately \$35,000, was recorded in connection with the acquisition of Erols and contribution to Starpower. These intangible assets are being amortized over approximately four years.

In February 1998, the Company acquired Ultranet Communications, Inc. ("Ultranet"). The total approximate consideration was \$7,700 in cash including cash payments aggregating approximately \$503 to certain holders of Ultranet stock options and the Company's Common Stock with a fair value of approximately \$26,200 at the time of issuance. Additionally, the purchase price includes approximately \$1,900 representing the fair value of UltraNet stock options which were converted to the Company's stock options in connection with the acquisition. The transaction was accounted for by the purchase method of accounting.

The Company contributed to RCN-BECOCOM approximately 30% of the subscribers acquired in the acquisition of Ultranet.

In connection with the acquisitions of Erols and UltraNet, the Company has allocated \$13,228 for Erols and \$5,065 for UltraNet to in-process research and development ("IPR&D"). Specifically, four projects were identified which qualified as IPR&D by definition of not having achieved technological feasibility and representing technology which at the point of acquisition offered no alternative use than the defined project. The fair value of the IPR&D projects associated with these acquisitions is based upon a discounted cash flow analysis modified to represent only that portion of the project associated with completed research and development efforts at the date of acquisition. The IPR&D valuation charge was measured by the stage of completion method. The expected completion percentages are estimated based on the available financial information at the date of acquisition and were established on a project by project basis primarily calculated by dividing the costs incurred to date by the total expected R&D expenses specific to the project. The significant assumptions utilized by management were as follows:

Cash flow projections, utilizing risk-adjusted discount rates of between 35% and 40% for Erols projects, commenced in 1998, and were expected to grow significantly in 1999 and 2000. Cash flow projections, utilizing risk-adjusted discount rates of between 30% and 33% for UltraNet projects, were expected to commence in 1999, growing significantly in 2000 and 2001. The IPR&D projections are founded on significant assumptions with regard to timing of market entrance, levels of penetration, and costs of provisioning.

The Company is constructing new telecommunications networks. The margins on products expected to result from acquired in-process technologies in some cases represent higher margins than the Company's margins on existing products primarily due to the efficiencies in delivering multiple products, including bundled service offerings, over a single state-of-the-art, high capacity fiber-optic network. For both the Erols and the UltraNet acquisitions, the Company identified the R&D development projects to include:

- Cable Modem Internet access for subscribers, consisting of projects to develop the hardware, systems and software to permit subscribers to be offered high-speed Internet access through direct cable connection.
- Internet Telephony, representing projects to develop the potential for dial-up telephone service through the Internet.
- E-Commerce Systems, consisting of the Company's efforts to develop a suitable system that would permit subscribers to conduct commercial activities over the Internet.
- High-speed shared office Internet access, representing a blending of fiber-optic and Internet networking technologies, which was under development as a package to be offered to commercial clients.

Relative to the qualification of these projects as IPR&D projects under the meaning within Statement of Financial Accounting Standards No. 2 ("SFAS 2"), each represented at the date of acquisition a development project associated with new and uncertain technology that was incomplete and had not reached technical feasibility. Further, the technology under development in each of these areas was not seen to present opportunities for alternative future use should the contemplated development project fail to achieve completion. In each of the above projects, the uncertainty associated with each, in the absence of a successful product introduction, may result in the possible abandonment of the project and the loss of both invested development funds and the profit contributions that such projects were expected to bring to the business as a whole.

The following unaudited pro forma summary presents information as if the acquisition of 21st Century had occurred at the beginning of 2000. The pro forma information is based on historical information and is provided for information purposes only. It does not necessarily reflect the actual results that would have occurred and is not necessarily indicative of future operational results of the consolidated entities.

Year Ended December 31, 2000

(Unaudited)	
Pro Forma Data:	
Sales	\$ 341,018
(Loss) from continuing operations before extraordinary items	\$(834,952)
Net (loss) to common shareholders	\$(957,704)
Earnings Per Share:	
(Loss) from continuing operations before extraordinary items	\$ (10.84)
Net (loss) to common shareholders	\$ (10.84)

5 Short-Term Investments

Short-term investments, stated at market, include the following at December 31, 2000 and 1999:

	2000	1999
Federal agency notes	\$ 320,326	\$ 178,524
Commercial paper	31,380	219,318
Corporate debt securities	467,968	289,898
Certificates of deposit	131,785	—
U.S. Treasury notes	137,078	434,500
Asset-backed securities	283,478	279,637
Total	\$1,372,015	\$1,401,877

At December 31, 2000, short-term investments with a market value of \$1,134,134 have contractual maturities of one to five years. All remaining short-term investments have contractual maturities less than one year.

6 Property, Plant and Equipment

Property, plant and equipment consists of the following at December 31,

	2000	1999
Telecommunications plant	\$1,350,998	\$ 580,544
Computer equipment	191,075	132,074
Buildings, leasehold improvements and land	88,320	42,959
Furniture, fixtures and vehicles	113,102	51,123
Construction materials	188,859	21,064
Construction in process	735,914	311,093
Other	8,350	5,967
Total property, plant and equipment	2,676,618	1,144,824
Less accumulated depreciation	(420,659)	(230,581)
Property, plant and equipment, net	\$2,255,959	\$ 914,243

Depreciation expense was \$171,141, \$80,894 and \$39,000 for the years ended December 31, 2000, 1999 and 1998, respectively.

7 Investments and Joint Ventures

Investments at December 31, are as follows:

	2000	1999
Megacable	\$ 83,205	\$ 86,191
Starpower Communications, LLC	119,149	74,733
JuniorNet Corporation	—	27,581
Other	2,592	2,066
Total Investments	\$204,946	\$190,571

At December 31, 2000 and 1999, the Company has a 50% interest in Starpower, a 48.96% interest in Megacable and a 47.5% interest in JuniorNet. The Company accounts for these investments on the equity method.

A. RCN-BECOCOM The Company is party to a joint venture with NSTAR Communications, Inc. ("NSTAR Communications"), a subsidiary of NSTAR, regarding construction of our Megaband™ Network and operation of our telecommunications business in the Boston metropolitan area. NSTAR is a holding company that, through its subsidiaries, provides regulated electric and gas utility services in the Boston area. Pursuant to the joint venture agreements, both parties have agreed to make capital contributions in accordance with their respective membership interests. In addition, the Company has access to and use of NSTAR's large fiber-optic network, rights-of-way and construction expertise. Pursuant to an exchange agreement between NSTAR Communications and the Company, NSTAR Securities has the right, from time to time, to convert portions of its ownership interest in

RCN-BECOCOM into shares of the Company's Common Stock, based on an appraised value of such interest. Shares issued upon such exchanges are issued to NSTAR Securities. As of December 31, 2000, NSTAR Securities has exchanged portions of its interest for a total of 4,097,193 shares of the Company's Common Stock. Following such exchanges, NSTAR Securities retains a 23.14% sharing ratio in the joint venture, and the right to invest as if it owned a 49% interest. Such investment percentage will decrease to the extent NSTAR Securities disposes of any such Company Common Stock. In April 2000, NSTAR Securities gave notice of its intent to convert its remaining ownership interest into shares of the Company's Common Stock. In October 2000, the Company and NSTAR Communications reached an agreement in principle regarding settlement of the final valuation of that exchange and to amend certain other agreements governing the RCN-BECOCOM, LLC joint venture (the "Joint Venture"). If the transaction is consummated pursuant to the agreement in principle, NSTAR Securities would receive 7.5 million shares of the Company's Common Stock in exchange for its remaining membership interest in the Joint Venture, representing \$152 million invested by NSTAR Communications. In addition, a new class of security in the Joint Venture would be created. NSTAR Communications would be permitted to invest up to \$100 million in such security, which would carry a cash coupon rate of 1.84% per month, guaranteed by the Company. Such coupon would include amortization of principal, which would be fully amortized over a fifteen-year term (callable after eight years, subject to certain make-whole requirements). NSTAR Communications, at its election, may choose to designate the amounts it contributes under future capital calls as either common equity or the new security in the Joint Venture. Future investments by NSTAR Communications would not be convertible into Company stock. In addition, the Joint Venture and NSTAR Communications would amend certain of their agreements to incorporate an incentive and penalty provision for construction activities and expand the relevant market in which the Joint Venture operates. The parties have been continuing to discuss this agreement in principle and no assurance can be given that it will be consummated on the terms described above. RCN-BECOCOM is consolidated in our financial statements.

B. Starpower The Company is party to a joint venture with Pepco Communications, Inc. ("Pepco"), a subsidiary of Potomac Electric Power Company ("Potomac"), regarding construction of our Megaband™ Network and operation of our telecommunications business in the Washington, D.C. metropolitan area, including parts of Virginia and Maryland, under the brand name "Starpower." Through its subsidiaries, Potomac is engaged in regulated utility operations and in diversified competitive energy and telecommunications businesses. Each of the Company and Pepco owns a 50% membership interest in Starpower. The Company provides certain services to the joint venture pursuant to support services and Internet services agreements. Pursuant to the joint venture agreements, both parties have agreed to make capital contributions in accordance with their respective membership interests. In addition, Starpower has access to and use of Potomac's large fiber-optic network, rights-of-way and construction expertise. Starpower is reflected in our financial statements under the equity method of accounting.

The Company recorded its proportionate share of (losses) of (\$20,208), (\$12,200) and (\$10,335) in 2000, 1999 and 1998, respectively.

C. Megacable The basis of the Company's investment in Megacable exceeded its underlying equity in the net assets of Megacable by approximately \$94,000.

As of July 31, 1999, the Company executed on a pledge of an 8.96% equity interest in Megacable made by Mazon Corporativo, S.A. de C.V. ("Mazon") to collateralize Mazon's indebtedness to the Company, which had a book value of \$18,373. As a result, the indebtedness was canceled, and the Company's underlying equity in the net assets of Megacable was increased by approximately \$7,000. The amortiza-

tion of the excess equity is done on a straight-line basis over a 15-year period. At December 31, 2000, the unamortized excess over the underlying equity in the net assets was \$66,600. The Company recorded its proportionate share of (losses) and amortization of excess cost over net assets of (\$1,695), (\$1,763) and (\$2,385) in 2000, 1999 and 1998, respectively.

D. JuniorNet Results for 2000 included a write-down of \$24,418 on an equity investment, which represents the Company's full investment in JuniorNet Corporation ("JuniorNet"). At December 31, 2000, the Company owned a 47.5% interest in JuniorNet. Although JuniorNet is still seeking a buyer or a strategic merger partner for the business, estimated future cash flows related to this investment indicated that an impairment of the full value had occurred.

8 Intangible Assets

Intangible assets consist of the following at December 31,

	2000	1999
Franchises and subscriber lists	\$ 91,310	\$ 87,796
Acquired current products/technologies	72,629	72,629
Non-compete agreements	12,470	11,100
Goodwill	463,187	103,785
Building access rights	15,295	15,295
Other intangible assets	9,705	6,270
Total intangible assets	664,596	296,875
Less accumulated amortization	(274,924)	(158,384)
Intangible assets, net	\$ 389,672	\$ 138,491

Amortization expense charged to operations in 2000, 1999 and 1998 was \$114,506, \$64,113 and \$50,088, respectively.

9 Deferred Charges

Deferred charges consist of the following at December 31,

	2000	1999
Debt issuance costs, net	\$54,772	\$60,639
Other	15,872	4,247
Total	\$70,644	\$64,886

10 Debt

Long-term debt outstanding at December 31, is as follows:

	2000	1999
Term Loans	\$ 500,000	\$ 500,059
Senior Notes 10% due 2007	225,000	225,000
Senior Discount Notes 11.125% due 2007	495,248	444,430
Senior Discount Notes 9.8% due 2008	462,818	420,591
Senior Discount Notes 11% due 2008	196,447	176,495
Senior Notes 10.125% due 2010	375,000	375,000
Capital Leases	3,199	2,746
Total	2,257,712	2,144,321
Due within one year	355	1,225
Total Long-Term Debt	\$2,257,357	\$2,143,096

In December 1999, the Company completed an offering of 10.125% Senior Notes with an aggregate principal amount of \$375,000 due 2010 (the "10.125% Indenture").

The 10.125% Senior Notes are general senior obligations of the Company which mature in January 2009. Interest on the 10.125% Senior Notes is payable in cash semi-annually in arrears on each July 15 and January 15, commencing July 15, 2000.

The 10.125% Senior Notes are redeemable, in whole or in part, at any time on or after January 15, 2005 at the option of the Company and have redemption prices starting at 105% of the principal amount and declining to 100% of the principal amount, plus any accrued interest.

In June 1999, the Company and certain of its subsidiaries together, (the "Borrowers") entered into a \$1,000,000 Senior Secured Credit Facility (the "Credit Facility"). The collateralized facilities are comprised of a \$250,000 seven-year revolving credit facility (the "Revolver"), a \$250,000 seven-year multi-draw term loan facility (the "Term Loan A") and a \$500,000 eight-year term loan facility (the "Term Loan B"). All three facilities are governed by a single credit agreement (the "Credit Agreement").

Also in June 1999, the Company prepaid its previous eight-year term credit facility in the amount of \$100,000 with the proceeds of the Credit Facility. The early extinguishment of the previous term credit facility prompted the write-off of the applicable unamortized debt issuance cost resulting in an extraordinary item of approximately (\$424).

The Revolver may be borrowed and repaid from time to time. At December 31, 2000, there were no outstanding loans under the Revolver. Up to \$150,000 of the Revolver may be used to fund working capital needs and for general corporate purposes. The remaining \$100,000 of the Revolver as well as the term loans may be used solely to finance telecommunications assets. The amount of the commitments under the Revolver automatically reduces to \$175,000 on June 3, 2005 and the remaining commitments are reduced quarterly in equal installments through to maturity at June 3, 2006. The Revolver can also be utilized for letters of credit up to a maximum of \$15,000. As of December 31, 2000 there were no letters of credit drawn under the Revolver.

The Term Loan A is available for drawing amounts until December 3, 2001. At December 31, 2000, there were no outstanding loans under the Term Loan A. Any outstanding borrowings under the Term Loan A at September 3, 2002 will be repaid in quarterly installments based on percentage increments of the Term Loan A that start at 3.75% per quarter on September 3, 2002 and increase in steps to a maximum of 10% per quarter on September 3, 2005 through to maturity at June 3, 2006.

As of December 31, 2000, \$500,000 of the Term Loan B was outstanding. Amortization of the Term Loan B starts on September 3, 2002 with quarterly installments of \$1,000 per quarter until September 3, 2006 when the quarterly installments increase to \$121,000 per quarter through to maturity at June 3, 2007.

The interest rate on the Credit Facility is, at the election of the Borrowers, based on either a LIBOR or an alternate base rate option. For the Revolver or Term Loan A borrowing, the interest rate will be LIBOR plus a spread of up to 300 basis points or the base rate plus a spread of 200 basis points, depending upon whether the Company's earnings before interest, income taxes, depreciation and amortization ("EBITDA") has become positive and thereafter upon the ratio of debt to EBITDA. In the case of the Revolver and the Term Loan A, a fee of 125 basis points on the unused commitment accrues until the Company's EBITDA has become positive and thereafter at up to 125 basis points depending upon the Company's utilization of the commitments. For all Term Loan B borrowings the interest includes a spread that is fixed at 350 basis points over the LIBOR or 250 basis points over the alternate base rate.

The Credit Agreement contains covenants customary for facilities of this nature, including financial covenants and covenants limiting debt, liens, investments, consolidation, mergers, acquisitions, asset sales, sale and leaseback transactions, payments of dividends and other distributions, making of capital expenditures and transactions with affiliates. The Borrowers must apply 50% of excess cash flow for each fiscal year commencing with the fiscal year ending on December 31, 2003 and certain cash proceeds realized from certain asset sales, certain payments under insurance policies and certain incurrences of additional debt to repay the Credit Facility.

The Credit Facility is collateralized by substantially all of the assets of the Company and its subsidiaries.

Prepayments of the eight-year term loan require payment of a fee of 2% of the amount of such prepayment if made on or prior to June 3, 2000 and 1% of such prepayment if made thereafter but on or prior to June 3, 2001.

The 11% Senior Discount Notes (the "11% Indenture") are general senior obligations of the Company, limited to \$256,755 aggregate principal amount at maturity and will mature on July 1, 2008. The 11% Senior Discount Notes were issued at a discount to yield gross proceeds of \$150,000. The 11% Senior Discount Notes will not bear cash interest prior to January 1, 2003.

The 11% Senior Discount Notes are redeemable, in whole or in part, at any time on or after July 1, 2003. The 11% Senior Discount Notes have redemption prices starting at 105.5% of the principal amount at maturity and declining to 100% of the principal amount at maturity, plus any accrued interest.

The 9.8% Senior Discount Notes (the "9.8% Indenture") are general senior obligations of the Company, limited to \$567,000 aggregate principal amount at maturity and will mature on February 15, 2008. The 9.8% Senior Discount Notes were issued at a discount to yield gross proceeds of \$350,587. The 9.8% Senior Discount Notes will not bear cash interest prior to February 15, 2003.

The 9.8% Senior Discount Notes are redeemable, in whole or in part, at any time on or after February 15, 2003 at the option of the Company. The 9.8% Senior Discount Notes have redemption prices starting at 104.9% of the principal amount at maturity and declining to 100% of the principal amount at maturity, plus any accrued interest.

In October 1997, the Company issued 10% Senior Notes with an aggregate principal amount of \$225,000 and 11.125% Senior Discount Notes with an aggregate principal amount at maturity of \$601,045, both due 2007. The Senior Discount Notes were issued at a discount and generated gross proceeds to the Company of \$350,000. In January 1998, the Company exchanged its 10% Senior Notes due 2007, Series B for any and all outstanding 10% Senior Notes due 2007, Series A and its 11.125% Senior Discount Notes due 2007, Series B for any and all outstanding 11.125% Senior Discount Notes due 2007, Series A.

The 10% Senior Notes were issued under an indenture dated October 17, 1997 (the "10% Indenture"). The 10% Senior Notes are general senior obligations of the Company which mature on October 15, 2007 and are collateralized by a pledge of the Escrow Account representing funds that, together with the future proceeds from the investment thereof, will be sufficient to pay interest on the 10% Senior Notes for six scheduled interest payments. Interest on the 10% Senior Notes is payable in cash semi-annually in arrears on each April 15 and October 15.

The 10% Senior Notes are redeemable, in whole or in part, at any time on or after October 15, 2002 at the option of the Company. The 10% Senior Notes have redemption prices starting at 105% of the principal amount and declining to 100% of the principal amount, plus any accrued interest.

The 11.125% Senior Discount Notes were issued under an indenture dated October 17, 1997 (the "11.125% Indenture"). The 11.125% Senior Discount Notes are general senior obligations of the Company, limited to \$601,045 aggregate principal amount at maturity and will mature on October 15, 2007. The 11.125% Senior Discount Notes were issued at a discount to yield gross proceeds of \$350,000. The 11.125% Senior Discount Notes will not bear cash interest prior to October 15, 2002.

The 11.125% Senior Discount Notes are redeemable, in whole or in part, at any time on or after October 15, 2002 at the option of the Company. The 11.125% Senior Discount Notes have redemption prices starting at 105.562% of the principal amount at maturity and declining to 100% of the principal amount at maturity, plus any accrued interest.

The 9.8% Senior Discount Notes, the 11% Senior Discount Notes, the 10% Senior Notes and the 11.125% Senior Discount Notes contain certain covenants that, among other things, limit the ability of the Company and its subsidiaries to incur indebtedness, pay dividends, prepay subordinated indebtedness, repurchase capital stock, engage in transactions with stockholders and affiliates, create liens, sell assets and engage in mergers and consolidations. At December 31, 2000, the Company was restricted from making any dividend payments under the terms of the Indentures.

Contractual maturities of long-term debt are as follows:

Year Ending December 31,	Aggregate Amounts
2001	\$ —
2002	\$2,000
2003	\$4,000
2004	\$4,000
2005	\$4,000

In July 1999, the Company entered into \$250,000 of two-year interest rate protection agreements with various counterparties. These agreements convert \$250,000 of the Company's floating rate debt under the Chase Facility to a fixed rate of approximately 6.08%. For the years ended December 31, 2000 and 1999, the Company's reported interest expense was approximately (\$631) lower in 2000 and \$432 higher in 1999 due to these agreements.

11 Income Taxes

The (benefit) for income taxes is reflected in the Consolidated Statements of Operations as follows:

	2000	1999	1998
Current:			
Federal	\$ (14)	\$ —	\$ —
State	73	659	1,149
Total Current	59	659	1,149
Deferred:			
Federal	(3,282)	(3,169)	(4,410)
State	(1,555)	(2,584)	(1,737)
Total Deferred	(4,837)	(5,753)	(6,147)
(Benefit) for income taxes:			
Before extraordinary item	(4,778)	(5,094)	(4,998)
Total (benefit) provision for income taxes	\$(4,778)	\$(5,094)	\$(4,998)

Temporary differences that give rise to a significant portion of deferred tax assets and liabilities at December 31, are as follows:

	2000	1999
Net operating loss carryforwards	\$ 563,355	\$ 213,961
Alternative minimum tax credits	12,747	—
Employee benefit plans	2,860	2,076
Reserve for bad debt	3,468	4,097
Start-up costs	11,916	3,980
Investment in unconsolidated entity	36,824	24,503
Deferred revenue	1,348	1,256
Intangibles	9,390	1,912
Other, net	8,895	6,535
Total deferred tax assets	650,803	258,320
Property, plant and equipment	(63,840)	(24,409)
Total deferred liabilities	(63,840)	(24,409)
Subtotal	586,963	233,911
Valuation allowance	(587,645)	(235,375)
Total deferred taxes	\$ (682)	\$ (1,464)

During 2000, the Company generated federal net operating losses in the amount of \$733,008 and acquired separate return limitation year (SRLY) net operating losses from the 2000 acquisitions of \$119,440 which results in a deferred tax asset totaling \$298,357. In the opinion of management, the Company is not certain of the realization of all of its deferred tax assets. Thus, a valuation allowance has been provided against the net federal deferred tax asset. A valuation allowance has also been provided, as in past years, against the state net operating losses, which, in the opinion of management, are also uncertain as to their realization.

The net change in the valuation allowance for deferred tax assets during 2000 and 1999 was an increase of \$352,270 and \$153,307, respectively.

Net operating losses will expire as follows:

	Federal	State
2007–2012	\$ 26,261	\$ 908,690
2017–2020	1,287,345	533,090
Total	\$1,313,606	\$1,441,780

The (benefit) for income taxes is different from the amounts computed by applying the U.S. statutory federal tax rate of 35%. The differences are as follows:

For the Years Ended December 31,	2000	1999	1998
(Loss) before (benefit) for income taxes and extraordinary item	\$(773,492)	\$(359,699)	\$(209,799)
Federal income tax benefit at statutory rate	\$(270,722)	\$(125,895)	\$ (73,430)
State income taxes net of federal income tax benefit	(963)	(1,042)	(382)
Federal valuation allowance	255,201	115,382	45,035
Write-down of acquired R&D costs	—	—	6,403
Amortization of goodwill	13,039	8,610	5,580
Contribution to subsidiary—Goodwill	—	—	3,744
Estimated nondeductible expenses	(3,000)	(3,000)	10,472
Stock options exercised	—	—	—
Other, net	1,667	851	(2,420)
Total (benefit) for income taxes	\$ (4,778)	\$ (5,094)	\$ (4,998)

12 Stockholders' Equity and Stock Plans

The Company has authorized 200,000,000 shares of \$1 par value Common Stock and 400,000,000 shares of \$1 par value Class B nonvoting Common Stock. The Company also has authorized 25,000,000 shares of \$1 par value preferred stock. At December 31, 2000, 87,104,229 shares of Common Stock are issued and 86,539,600 shares of Common Stock are outstanding. At December 31, 1999, 77,724,070 shares of Common Stock are issued and 77,162,070 shares of Common Stock are outstanding.

■ Incentive Stock Options

The 1997 RCN Corporation Stock Option Plan (the "1997 Plan") contemplates the issuance of incentive stock options, as well as stock options that are not designated as incentive stock options, performance-based stock options, stock appreciation rights, performance share units, restricted stock, phantom stock units and other stock-based awards (collectively, "Awards"). Up to 30,000,000 shares of Common Stock, plus 3,040,100 shares of Common Stock issuable in connection with the Distribution related option adjustments, may be issued pursuant to Awards granted under the 1997 Plan.

Unless earlier terminated by the Company Board, the 1997 Plan will expire on the tenth anniversary of the Distribution.

The Company granted 5,322,034 Incentive Stock Options ("ISOs") to employees during the year ended December 31, 2000 with a fair value under SFAS No. 123 of \$10,308. The fair value recognized under SFAS No. 123 for the ISOs granted to employees for services performed prior to December 31, 2000 was approximately \$27,845. As of December 31, 2000, the Company had not reflected \$17,537 of unamortized compensation expense in its financial statements for options granted in 2000.

The fair value for these options was estimated at the date of grant using a Black Scholes option pricing model with weighted average assumptions for dividend yield of 0% for 2000, 1999 and 1998; expected volatility of 86.4% for 2000, 59.9% for 1999, and 78.9% for 1998; risk-free interest rate of 5.06%, 5.62% and 4.72% for 2000, 1999 and 1998, respectively; and expected lives of 3 years for 2000, 3 years for 1999 and 5 years for 1998.

The weighted average fair value of options granted during 2000 was \$15.20.

Information relating to Incentive stock options and Non-qualified stock options are as follows:

	Number of Shares	Weighted Average Exercise Price
Outstanding December 31, 1997	7,107,100	\$11.95
Granted	2,527,424	\$14.81
Exercised	408,389	\$ 4.82
Canceled	<u>373,993</u>	\$15.22
Outstanding December 31, 1998	8,852,142	\$12.96
Granted	3,393,071	\$41.63
Exercised	1,507,119	\$23.72
Canceled	<u>1,153,222</u>	\$ 8.26
Outstanding December 31, 1999	9,584,872	\$22.34
Granted	5,322,034	\$23.09
Exercised	567,434	\$11.66
Canceled	<u>1,354,762</u>	\$28.94
Outstanding December 31, 2000	12,985,110	\$22.40
Shares exercisable December 31, 2000	5,020,181	\$16.74

The following table summarizes stock options outstanding and exercisable at December 31, 2000:

Range of Exercise Prices	Stock Options Outstanding			Stock Options Exercisable	
	Shares	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
1.30–15.36	5,449,115	5.8	\$11.43	3,758,272	\$10.36
15.37–30.74	5,055,431	4.7	\$23.09	472,524	\$21.59
30.75–44.99	1,156,060	3.7	\$41.14	379,019	\$41.34
45.00–60.11	1,220,504	3.6	\$47.14	410,366	\$46.93
60.12–70.50	104,000	4.2	\$65.06	—	
	<u>12,985,110</u>	<u>5.0</u>		<u>5,020,181</u>	

■ Outperform Stock Option Plan

In June 2000, the Company adopted an Outperform Stock Option ("OSO") program pursuant to the Company's 1997 Equity Incentive Plan. The OSO program was designed so that the Company's stockholders would receive a market return on their investment before OSO holders receive any return on their options. The Company believes that the OSO program aligns directly management's and stockholders' interests by basing the ultimate stock option value on the Company's ability to outperform the market in general, as measured by the Standard & Poor's ("S&P") 500 Index over the term of the option.

Participants in the OSO program do not realize any value from awards unless the common stock price outperforms the S&P 500 Index. When the stock price gain is greater than the corresponding gain on the S&P 500 Index, the value received for awards under the OSO program is based on a formula involving a multiplier related to the level by which the Common Stock outperforms the S&P 500 Index. To the extent that the Company's Common Stock outperforms the S&P 500 Index, the value of the OSOs to a holder may exceed the value of other stock options.

OSO grants are made to participants employed on the date of the grant. Each award vests in equal installments over five years and has a ten-year life.

The Company granted 3,000,000 OSOs to employees during the year ended December 31, 2000 with a fair value under SFAS No. 123 of \$42,776. The Company recognized \$17,910 of compensation expense during the year 2000 for options granted in 2000. As of December 31, 2000, the Company had not reflected \$24,866 of unamortized compensation expense in its financial statements for options granted in 2000.

The fair value for these options was estimated at the date of grant using a Black Scholes option pricing model with weighted average assumptions for dividend yield of 0% for 2000, 1999 and 1998; expected volatility of 86.4% for 2000, 59.9% for 1999, and 78.9% for 1998; risk-free interest rate of 5.06%, 5.62% and 4.72% for 2000, 1999 and 1998, respectively; and expected lives of 5 years for 2000.

Information relating to Outperform Stock Options is as follows:

	Number of Shares	Weighted Average Exercise Price
Outstanding December 31, 1999	—	
Granted	3,000,000	\$38.12
Exercised	—	\$ —
Canceled	—	\$ —
Outstanding December 31, 2000	3,000,000	\$38.12
Shares exercisable December 31, 2000	600,000	\$38.12

■ Restricted Stock

In 2000, the Company issued 570,257 shares of restricted stock with a fair value of \$37,941. During the performance period the grantee may vote the shares, but the shares are subject to transfer restrictions and are all or partially forfeited if a grantee terminates employment with the Company. The restricted stock vests over three years, 1/3 after year two and the remaining 2/3 after year three. The restricted stock is considered issued and outstanding.

The Company recorded \$12,052 of non-cash compensation expense for the year ended December 31, 2000 relating to its restricted stock program.

As of December 31, 2000, the Company had unearned compensation costs of \$25,889 which is being amortized to expense over the restriction period.

■ Preferred Stock

On February 28, 2000, Vulcan Ventures Incorporated ("Vulcan"), the investment organization of Paul G. Allen, made a \$1.65 billion investment in the Company. The investment is in the form of mandatorily convertible cumulative preferred stock (the "Series B Preferred Stock"), which will be converted into Common Stock or Class B Stock, no later than seven years after it is issued. We have the option of redeeming at any time after August 28, 2003. Vulcan has purchased 1,650,000 shares of the Series B Preferred Stock. The Series B Preferred Stock has a liquidation preference of \$1,000 per share and is convertible at a price of \$62 per share. All dividends will be paid in additional shares of Preferred Stock. At December 31, 2000, we had paid cumulative dividends in the amount of \$98,965 in the form of 1,596,212 additional Series B Preferred Stock. At December 31, 2000, the number of shares that would be issued upon conversion of the Series B Preferred Stock was 28,209,113. In connection with the investment, Vulcan appointed William D. Savoy, President of Vulcan, and Edward S. Harris, Investment Analyst with Vulcan, to our Board of Directors. The Preferred Stock has a dividend rate of 7% per annum.

On April 7, 1999, Hicks, Muse, Tate & Furst, through Hicks Muse Fund IV, purchased 250,000 shares of Series A Preferred Stock, par value \$1 per share, for gross proceeds of \$250,000. The Series A Preferred Stock is convertible into Common Stock at any time and is subject to a mandatory redemption on March 31, 2014 at \$1.00 per share, plus accrued and unpaid dividends, but may be called by the Company after four years. The Series A Preferred Stock is cumulative and has an annual dividend rate of 7% payable quarterly in cash or additional shares of Series A Preferred Stock and has a conversion price of \$39.00 per share. At December 31, 2000, we had paid cumulative dividends in the amount of \$31,955 in the form of 819,336 additional Series A Preferred Stock. At December 31, 2000, the number of common shares that would be issued upon conversion of the Series A Preferred Stock was 7,229,615. In connection with the investment, Hicks, Muse, Tate & Furst appointed Michael Levitt to our Board of Directors.

■ Equity Offerings

In June 1999 the Company completed a public offering of 9,200,000 shares of RCN Common Stock, with a price to the Public of \$39.00 per share. The net proceeds to the Company were approximately \$344,043 after deducting issuance costs.

In June 1998, the Company completed a public offering of 6,794,500 shares of RCN Common Stock, with a price to the Public of \$19.50 per share. Of the 6,794,500 shares offered, 6,098,355 were offered by the Company and 696,145 shares were offered by a Selling Stockholder. The net proceeds to the Company were approximately \$112,866 after deducting issuance costs.

■ Stock Split

In March 1998, the Company's Board of Directors approved a two-for-one stock split, payable in the form of a 100% stock dividend. All share and per share data, stock option data, and market prices of the Company's Common Stock have been restated to reflect this stock dividend.

■ Pro Forma Disclosure

No compensation expense related to employee stock options granted prior to January 1, 2000 was recorded in 2000, 1999 or 1998 as the option exercise prices were equal to fair market value on the date granted.

Pro forma information regarding net income and earnings per share is required by SFAS 123, and has been determined as if the Company had accounted for its stock options under the fair value method of SFAS 123 for periods prior to January 1, 2000. The fair value for these options was estimated at the date of grant using a Black Scholes option pricing model with weighted average assumptions for dividend yield of 0% for 1999 and 1998; expected volatility of 59.9% for 1999, and 78.9% for 1998; risk-free interest rate of 5.62% and 4.72% for 1999 and 1998, respectively; and expected lives of 3 years for 1999 and 5 years for 1998.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The Company's pro forma net earnings and earnings per share were as follows:

	2000	1999	1998
Net (loss)—as reported	\$ (891,466)	\$(368,570)	\$(205,442)
Net (loss)—pro forma	\$(1,047,708)	\$(384,941)	\$(214,586)
Basic and diluted (loss) per share—as reported	\$ (10.59)	\$ (5.12)	\$ (3.36)
Basic and diluted (loss) per share—pro forma	\$ (12.44)	\$ (5.34)	\$ (3.51)

■ Executive Stock Purchase Plan

The Company has an Executive Stock Purchase Plan ("ESPP"), under which participants may defer, on a tax free basis, up to 20% of their annual salary plus bonus. The deferred funds are used to purchase shares of RCN Common Stock. Share units corresponding to the shares purchased credited to participants' accounts, and held for the benefit of the participant until the earlier of the end of the deferral period (no less than 3 years) or termination of employment. The Company issues a matching share unit for each share unit credited to a participant's account. The share units do not give such participant any rights as a shareholder. The matching share units vest three years from the deferral and are subject to forfeiture as provided in the ESPP.

The number of shares which may be distributed under the RCN ESPP as matching shares or in payment of share units is 500,000. At December 31, 2000, there were 155,740 RCN ESPP shares arising from participants' contributions and 155,740 matching shares. The Company recognizes the cost of the

matching shares over the vesting period. At December 31, 2000, deferred compensation cost relating to matching shares was \$1,498. Expense recognized in 2000, 1999 and 1998 was \$963, \$656 and \$615, respectively. Matching shares are included in weighted average shares outstanding for purposes of computing earnings per share.

13

Pensions and Employee Benefits

In 1997, RCN established a 401(k) savings plan that also qualifies as an ESOP (the “ESOP”). Contributions charged to expense in 2000, 1999 and 1998 for these plans were \$3,687, \$1,948 and \$1,596, respectively.

The Company provides certain postemployment benefits to former or inactive employees of the Company who are not retirees. These benefits are primarily short-term disability salary continuance. The Company accrues the cost of postemployment benefits over employees’ service lives. The Company uses the services of an enrolled actuary to calculate the expense. The net periodic postemployment benefit cost was approximately \$1,028, \$303 and \$543 in 2000, 1999 and 1998, respectively.

14

Commitments and Contingencies

A. The Company had various purchase commitments at December 31, 2000 related to its 2001 construction budget.

B. Total rental expense, primarily for office space and equipment, was \$32,237, \$18,321 and \$10,475 for 2000, 1999 and 1998, respectively. At December 31, 2000, rental commitments under noncancelable leases, excluding annual pole rental commitments of approximately \$1,543 that are expected to continue indefinitely, are as follows:

Year	Aggregate Amounts
2001	\$ 49,201
2002	\$ 46,153
2003	\$ 43,071
2004	\$ 41,851
2005	\$ 38,240
Thereafter	\$248,380

- C. The Company has outstanding letters of credit aggregating \$15,006 at December 31, 2000.
- D. In the normal course of business, there are various legal proceedings outstanding. In the opinion of management, these proceedings will not have a material adverse effect on the financial position or results of operations or liquidity of the Company.
- E. The Company has agreed to indemnify Cable Michigan and CTE and their respective subsidiaries against any and all liabilities which arise primarily from or relate primarily to the management or conduct of the business of the Company prior to the effective time of the Distribution. The Company has also agreed to indemnify Cable Michigan and CTE and their respective subsidiaries against 30% of any liability which arises from or relates to the management or conduct prior to the effective time of the Distribution of the businesses of C-TEC and its subsidiaries and which is not a true CTE liability, a true Cable Michigan liability or a true Company liability.

The Tax Sharing Agreement, by and among the Company, Cable Michigan and CTE (the "Tax Sharing Agreement"), governs contingent tax liabilities and benefits, tax contests and other tax matters with respect to tax returns filed with respect to tax periods, in the case of the Company, ending or deemed to end on or before the Distribution Date. Under the Tax Sharing Agreement, Adjustments (as defined in the Tax Sharing Agreement) to taxes that are clearly attributable to the Company Group, the Cable Michigan Group, or the CTE Group will be borne solely by such group. Adjustments to all other tax liabilities will be borne 50% by CTE, 30% by the Company and 20% by Cable Michigan.

Notwithstanding the above, if as a result of the acquisition of all or a portion of the capital stock or assets of the Company or as a result of any other action taken by the Company, the distribution fails to qualify as a tax-free distribution under Section 355 of the Code, then the Company will be liable for any and all increases in tax attributable thereto.

F. If, by September 30, 2002, the ESOP portion of the 401(k) Plan does not hold shares representing 3% of the total number of shares of Company Common Stock outstanding at September 30, 1997 as increased by the number of shares issuable to NSTAR Securities pursuant to the Exchange Agreement (collectively, "Outstanding Company Common Stock") with a market value at such time of not less than \$24,000, the Company will issue to the ESOP, in exchange for a note from the ESOP (the "ESOP Note"), the amount of Company Common Stock necessary to increase the ESOP's holdings of Company Common Stock to that level, provided, however, that the Company is not obligated to issue shares to the ESOP in excess of 5% of the total number of shares of Outstanding Company Common Stock.

As of December 31, 2000, the ESOP holds 29,746 shares of outstanding Company Common Stock.

15 Related Party Transactions

The Company had the following transactions with related parties during the years ended December 31, 2000, 1999 and 1998:

	2000	1999	1998
Corporate office costs allocated to related parties	\$ 1,996	\$ 5,235	\$ 9,946
Terminating revenues from related party	7,066	8,948	14,878
Expenses allocated to unconsolidated joint venture partner	21,776	21,466	14,681
Related party expenses for network construction	83,675	48,878	—
Related party expenses for utility service	2,392	2,236	—

At December 31, 2000 and 1999, the Company has accounts receivable from related parties of \$37,874 and \$8,015, respectively, for these transactions. At December 31, 2000 and 1999, the Company has accounts payable to related parties of \$89,800 and \$35,809, respectively, for these transactions.

16 Off Balance Sheet Risk and Concentration of Credit Risk

Certain financial instruments potentially subject the Company to concentrations of credit risk. These financial instruments consist primarily of trade receivables, cash and temporary cash investments, and short-term investments.

The Company places its cash, temporary cash investments and short-term investments with high credit quality financial institutions and limits the amount of credit exposure to any one financial institution. The Company also periodically evaluates the creditworthiness of the institutions with which it invests. The Company does, however, maintain invested balances in excess of federally insured limits.

The Company's trade receivables reflect a customer base primarily centered in the Boston to Washington, D.C. corridor of the United States. The Company routinely assesses the financial strength of its customers. As a consequence, concentrations of credit risk are limited.

17 Disclosure About Fair Value of Financial Instruments

A. Cash and temporary cash investments

These investments are carried at market value.

B. Short-term investments

Short-term investments consist of commercial paper, U.S. Treasury Notes, asset-backed securities, corporate debt securities, certificates of deposit and federal agency notes. Short-term investments are carried at market value.

C. Long-term investments

Long-term investments consist of investments accounted for under the equity method for which disclosure of fair value is not required. The note and interest receivable are carried at cost plus accrued interest which management believes approximates fair value.

D. Long-term debt

The fair value of long-term debt was estimated based on the Company's current incremental borrowing rate for debt of the same remaining maturities.

E. Letters of credit

The contract amount of letters of credit represents a reasonable estimate of their value since such instruments reflect fair value as a condition of their underlying purpose and are subject to fees competitively determined in the marketplace.

The estimated carrying fair value of the Company's financial instruments is as follows at December 31:

	2000		1999	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial Assets:				
Cash and temporary cash				
investments	\$ 356,377	\$ 356,377	\$ 391,412	\$ 391,412
Short-term investments	\$1,372,015	\$1,372,015	\$1,401,877	\$1,401,877
Investments restricted for				
debt service	\$ —	\$ —	\$ 23,159	\$ 21,684
Financial Liabilities:				
Fixed rate long-term debt:				
Senior Notes 10.125%	\$ 375,000	\$ 225,000	\$ 375,000	\$ 375,000
Senior Notes 10%	\$ 225,000	\$ 137,250	\$ 225,000	\$ 223,875
Senior Discount Notes 11.125%	\$ 495,248	\$ 240,418	\$ 448,430	\$ 426,742
Senior Discount Notes 9.8%	\$ 462,818	\$ 204,120	\$ 420,591	\$ 371,385
Senior Discount Notes 11.0%	\$ 196,447	\$ 102,702	\$ 176,495	\$ 166,891
Floating rate long-term debt:				
Term Loan B (Note 10)	\$ 500,000	\$ 450,000	\$ 500,000	\$ 500,000
Unrecognized financial instruments:				
Letters of credit	\$ 15,006	\$ 15,006	\$ 4,914	\$ 4,914

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Quarterly Information (Unaudited)

2000	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Sales	\$ 71,257	\$ 78,952	\$ 88,245	\$ 94,996
Operating (loss) before non-cash stock-based compensation, depreciation and amortization	\$ (67,550)	\$ (72,696)	\$ (83,147)	\$(108,566)
Operating (loss)	\$(111,962)	\$(151,782)	\$(182,391)	\$(212,709)
Net (loss)	\$(138,121)	\$(172,860)	\$(198,038)	\$(259,695)
Common Stock				
High	\$ 72.00	\$ 51.50	\$ 29.75	\$ 19.00
Low	\$ 45.06	\$ 20.06	\$ 17.50	\$ 6.06
1999	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Sales	\$ 67,388	\$ 66,929	\$ 69,622	\$ 72,054
Operating (loss) before depreciation, amortization and nonrecurring charges	\$ (21,449)	\$ (25,406)	\$ (32,587)	\$ (52,525)
Operating (loss)	\$ (53,723)	\$ (55,947)	\$ (68,720)	\$ (99,620)
Loss before extraordinary item	\$ (67,754)	\$ (63,358)	\$ (91,774)	\$(131,718)
Loss before extraordinary item per average share	\$ (1.03)	\$ (0.97)	\$ (1.26)	\$ (1.78)
Net (loss)	\$ (67,754)	\$ (63,782)	\$ (91,774)	\$(131,718)
Common Stock				
High	\$ 39.75	\$ 54.50	\$ 51.50	\$ 54.25
Low	\$ 17.75	\$ 33.75	\$ 32.25	\$ 37.31

Report of Management

The integrity and objectivity of the financial information presented in these financial statements is the responsibility of the management of RCN Corporation.

The financial statements report on management's accountability for Company operations and assets. To this end, management maintains a system of internal controls and procedures designed to provide reasonable assurance that the Company's assets are protected and that all transactions are accounted for in conformity with accounting principles generally accepted in the United States. The system includes documented policies and guidelines, augmented by a comprehensive program of internal and independent audits conducted to monitor overall accuracy of financial information and compliance with established procedures.

PricewaterhouseCoopers LLP, independent accountants, conduct a review of internal accounting controls to the extent required by generally accepted auditing standards and perform such tests and procedures as they deem necessary to arrive at an opinion on the fairness of the financial statements presented herein.

The Board of Directors meets its responsibility for the Company's financial statements through its Audit Committee which is comprised exclusively of directors who are not officers or employees of the Company. The Audit Committee recommends to the Board of Directors the independent auditors for election by the shareholders. The Committee also meets periodically with management and the independent and internal auditors to review accounting, auditing, internal accounting controls and financial reporting matters. As a matter of policy, the internal auditors and the independent auditors periodically meet alone with, and have access to, the Audit Committee.



Timothy J. Stoklosa

*Executive Vice President and
Chief Financial Officer*

Report of Independent Accountants

To the Shareholders of RCN Corporation:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, changes in common shareholders' equity/(deficit), and cash flows present fairly, in all material respects, the financial position of RCN Corporation and its subsidiaries at December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2 to the financial statements, the Company changed its method of accounting for stock-based compensation in 2000.



PricewaterhouseCoopers LLP

Philadelphia, Pennsylvania

March 2, 2001

Board of Directors

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RCN Corporation

Michael A. Adams

President, Wholesale and
New Product Development,
RCN Corporation

Timothy J. Stoklosa

Executive Vice President and
Chief Financial Officer,
RCN Corporation

James Q. Crowe

President and Chief
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Level 3 Communications, Inc.

Alfred Fasola

Chief Executive Officer,
Jumbo Sports, Inc.

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Skanska USA, Inc.

Edward S. Harris

Senior Investment Analyst,
Vulcan Ventures, Inc.

Richard R. Jaros

Retired President,
Kiewit Diversified Group, Inc.,
and Retired Chief
Financial Officer,
Peter Kiewit Sons', Inc.

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Partner,
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Thomas P. O'Neill, III

Chief Executive Officer,
GPC-O'Neill & Associates

Eugene Roth, Esq.

Senior Partner,
Rosenn, Jenkins &
Greenwald, L.L.P.

William D. Savoy

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Vulcan Ventures, Inc.

Walter Scott, Jr.

Chairman of the Board,
Level 3 Communications, Inc.

Michael B. Yanney

Chairman and Chief
Executive Officer,
America First Companies, L.L.C.

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Executive Officer

Robert J. Currey

Vice Chairman

Jeffrey White

President, Customer and
Field Operations

Michael A. Adams

President, Wholesale and
New Product Development

Timothy J. Stoklosa

Executive Vice President and
Chief Financial Officer

John J. Jones

Executive Vice President,
General Counsel and
Corporate Secretary

Committees

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Michael A. Adams
James Q. Crowe
William D. Savoy
Walter Scott, Jr.

Compensation Committee

Eugene Roth, Esq., Chairman
Alfred Fasola
Michael B. Yanney

Audit Committee

Alfred Fasola, Chairman
Richard R. Jaros
Michael J. Levitt
Thomas J. May
Thomas P. O'Neill, III

Corporate Information

Corporate Headquarters

RCN Corporation
105 Carnegie Center
Princeton, NJ 08540
(609) 734-3700

Shareholder Account Assistance

Questions about lost stock certificates, stock transfers, address changes, registration changes or other shareholder matters should be directed to the transfer agent and registrar listed below.

Mellon Investor Services, L.L.C.
Shareholder Relations
Department
P.O. Box 3315
South Hackensack, NJ 07606
(800) 647-4273
www.mellon-investor.com

Independent Public Accountants

PricewaterhouseCoopers LLP
2400 Eleven Penn Center
Philadelphia, PA 19103-2962

Annual Meeting

The annual meeting of shareholders is scheduled for 11:00 A.M., Thursday, May 17, 2000, at the Princeton Marriott Forrester Village. The hotel is located at 201 Village Boulevard, Princeton, NJ 08540, (609) 452-7900.

Investor Relations Information

Members of the financial community and shareholders seeking additional information about the company are invited to contact:

Valerie C. Haertel
Senior Vice President of
Investor Relations and
Corporate Communications

RCN Corporation
105 Carnegie Center
Princeton, NJ 08540
Phone (609) 734-3732
Fax (609) 720-5867
E-mail ir@rcn.com

Requests for additional financial information such as Forms 10K and 10Q, which are filed with the Securities and Exchange Commission, are available from Investor Relations and can be obtained by visiting our Web site at www.rcn.com, by writing to the corporate headquarters or by calling the information request line at (609) 734-3732.

Common Stock

The Nasdaq National Market
Symbol: RCNC

Media Relations Information

For press inquiries, contact:

Nancy Bavec
Director, Public Relations
RCN Corporation
105 Carnegie Center
Princeton, NJ 08540

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